United States Court of Appeals

for the Second Circuit

APPENDIX

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B

74-1221-1490

P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 74-1221 and 74-1490

CITIES SERVICE COMPANY,
Plaintiff-Appellee-Appellant,

—against—

UNITED STATES OF AMERICA,
Defendant-Appellant-Appellee.

CONSOLIDATED APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX
Volume I—Pages A-1 to A-330

UNITED STATES COURT OF APPEALS
FILED
JUL 17 1974
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

PAUL J. CURRAN,
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264-6350

CASEY, CRAIG & CONSTANCE,
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New York, New York 10017,
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490-8440

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NITED STATES DISTRICT COURT

Jury demand date:

orm No. 106 Rev. A 1

TITLE OF CASE	ATTORNEYS
S SERVICE COMPANY	For plaintiff: Casey, Tyre, Craig & Antholi
VS	~~Clark, Carr and Ellis~~ Suite 2832
D STATES OF AMERICA	~~120 Broadway, NY 10005~~ (Di 9-2020)
	Casey, Tyre, Wallace & Bannerman
	345 Park Ave., NYC
	For defendant:
	U. S. Atty.

STATISTICAL RECORD	COSTS		DATE	NAME OR RECEIPT NO.	REC.		DISB.	
5 mailed X	Clerk							
6 mailed	Marshal							
is of Action: Action pursuant	Docket fee							
itle 28 USC Section 1346 (a) (1)								
payment of federal income	Witness fees							
$Undetermined								
ion arose at:	Depositions							

DATE	PROCEEDINGS	Date Ord Judgment
Nov.22-67	Filed complaint and issued summons	
c 7-67	Filed summons & return, served U.S.A. by P. Troia, Clerk, U.S. Atty's office & by certified mail, recpt. #815797, to Atty Gen'l, Wash., D.C. 11-24-67	
b 1-68	Filed stip. & order extending time of deft. to answer to 2-23-68.-Murphy,J.	
r.6-68	Filed stipulation and order extending defendant's time to answer complaint to 3/22/68. Herlands, J.	
y. 31-6	Filed ANSWER	USAtty
y. 31-6	Filed stip. & order extending time of deft. to answer to 5-31-68--McLean, J.	
ul 11-9	Filed Consent Order - Robert J. Casey, Thomas E. Tyre, John A. Craig and John K. Antholis, 120 Broadway, New York be substituted as attys. of record for pltff. - so ordered-Clerk	
ov 26-69	Filed deft's affdvt & notice of motion for summary judgment ret. 12-2-69.	
ov 26-69	Filed deft's memorandum in suppt. of motion filed 11-26-69	
c.1-69	Filed stip that motion for summary judgment is adjourned to 2-10-70.	
n.28-70	Filed pltff's statement purs. to 9g in opposition to motion for summary judgment.	
n.28-70	Filed memorandum of law in opposition to deft's motion for summary judgment.	
r.29-70	Filed notice of change of address of atty. for pltff.	
l 24-70	Filed pltff's motion to correct the record as indicated	
l 24-70	Filed pltff's rebuttal memorandum	
l 24-70	Filed stipulation with respect to 560,000 shares of its $6 preferred capitol stock & $86,000 shares of its 6% preference B Capitol stock etc. as indicated	
l 24-7	Filed Opinion #36985 - Pltff's motion for summary judgment is denied. Accordingly a trial will be conducted as to remaining issue & once the value of shares received has been determined, any refunds due pltff will be determined by simple mathematical computation-Deft's motion is denied in all respects-Settle order on notice-Mansfield,J.	
c 9-70	Filed deft USA affdvt,statement pursuant to Rule 9g & notice of motion for summary judgment ret. 12-22-70	
ec 9-70	Filed deft USA memorandum in support of its motion for summary judgme	
ec 21-70	Filed stipulation extending return date on deft's notice of motion for summary judg. from 12-22-70 to 2-9-71	
Jan 28-71	Filed pltff's memorandum of law in opposition to deft's second motion for summary judg.	
et 11-71	Filed Order that deft's & pltff's motions for summary judgment are denied ; that this case be set down for trial in due course with the sole factual question to be resolved thereat being the value to pltff of the preferred & preference shares received by it in exchange for the issuance of its 3% Thirty Year Sinking Funds Debentures ("the Bonds") on 5-27-47; that the bonds shall be deemed issued at a price equal to value to pltff of the preferred stocks received in exchange for their issuance on 5-27-47 & it is ordered that the value of those shares to pltff shall be no less than $45,323,846. It isfurther ordered that upon resolution of sole remaining factual issue, the amt. of any deductible loss or discount will be determined by mathematical calculation-Mansfield,J. m/n	
ne 21-71	Filed pltff's response to deft's reply memorandum	
ne 21-71	Filed deft's reply memorandum to to pltff's memorandum in opposition to mot.	
e 21-71	Filed Opinion #37736---Deft's second motion for summary judgment is denied-So ordered-Wyatt,J. m/n	
y 19-71	Filed ORDER that pltff shall file a note of issue within 120 days or action to be dismissed-Edelstein,Ch.J. m/n	
y 24-71	Filed deft USA interrogatories to pltff	
30-71	Filed pltff's interrogatories to deft USA	
30-71	Filed pltff's answers to interrogatories of deft	
an 14-72	Filed pltff's NOTE OF ISSUE & Statement of readiness	
n 19-72	Filed deft's answers to interrogatories of pltff	

DATE	PROCEEDINGS ASSIGNED TO TENNEY J.
Jan 21-72	Filed deft USA objections to note of issue
Feb 1-72	Filed memo endorsed on objections filed 1-21-72--opposition overruled, Note of issue may be filed-So ordered-Frankel,J. m/n
Apr 12-72	Filed deft USA notice to take deposition of L. Sanford Reis on 4-20-72
Apr 28-72	Filed deft's amended notice to take deposition of L. Sanford Reis on 5-24-72
May 1[illegible] 72	Filed Amended notice to take deposition of L. Sanford Reis, c/o Reis & Chandler, Inc. on Jun 2 1972.
JUN[illegible]5 72	Filed Deft's notice to take deposition of Marvin Chandler.
JULY [illegible] 72	Filed Deposition of Marvin Chandler on 6-28-72. m/n
JUL 1[illegible] 72	Filed pltff's Suppl. answers to interrogs.
JUL 17 72	TRIAL BEGUN BEFORE TENNEY, J. NON-JURY.
JUL 18 72	TRIAL CONTINUED.
JUL 19 72	TRIAL CONTINUED & CONCLUDED. - decision reserved.
SEP 1[illegible]2	Filed Stip of errors and corrections, on transcript of trial held Jul 17 thru Jul 19 1972.
SEPT [illegible] 72	Filed Pltff's requested Findings of fact & conclusions of law and brief in support.
Sep.15 72	Filed Reply Brief for Plaintiff.
NOV [illegible] 72	Filed Transcript of record of proceedings, dated July 17 & 19 1972
Jun[illegible]2-73	Filed pltff's requested findings of fact and conclusions of law and brief in support thereof.
Jun 2-73	Filed pltff's requested findings of fact and conclusions of law and brief in support thereof.
Jun 12-73	Filed deft's proposed findings of fact.
Jun.12-73	Filed pltff's reply brief.
Jun12-73	Filed reply brief for pltff.
Jun12-73	Filed Govt's post-trial memorandum.
Jun12-73	Filed Govt's reply memorandum.
Jun12-73	Filed Govt's trial memorandum of United States.
Jun12-73	Filed OPINION#39550-...Accordingly, the Court finds that the value to pltff of the preferred and preference shares received by it in exchange for the issue of its 3 percent Thirty Year Sinking Debentures on 5-27-47 was $86,313,600.00.said valuation being computed as follows...Submit final judgment in conformity herew and with the prior orders entered herein on twenty days notice. TENNEY,J. (mn)
Nov.13-73	Filed Pltff s Reply Memorandum of Law in supposed of its proposed Judgment.
Nov.20-73	Filed JUDGMENT #73,917.Pltff entitled to refund of Federal Income Taxes for calendar taxable years ending 12/31/53&12/31/54 in amounts of $636,342.11and $735,055.80 plus int.Tenney,J . JUDGMENT ENTERED.Clerk (n/m) ENT.11/23/73
Nov.20-73	Filed Deft's Memorandum of Law in support of its proposed judgment.
Nov.20-73	Filed Pltff's Reply Memorandum of Law in support of its proposed judgment.
Jan.15-74	Filed deft.U.S.A.'s Notice of Appeal from Judgment filed Nov.20, 1973.(Mailed copy to Thomas E.Tyre on 1/17/74)
Jan.23-74	Filed Pltff's Notice of Cross Appeal from those certain parts of the final judgment entered on 11/20/73 (Mailed copy to Paul J.Curran,Esq. on 1/25/74)
Jan.23-74	Filed Bond for Untertaking for Costs on Appeal in sum of $250. (Fireman's Fund)

UNITED STATES DISTRICT COURT A 4

FOR THE SOUTHERN DISTRICT

OF NEW YORK

- - - - - - - - - - - - - - - - - - X

CITIES SERVICE COMPANY, :

Plaintiff, :

Civil Action, File No._____

v. :

UNITED STATES OF AMERICA, : COMPLAINT

Defendant. :

- - - - - - - - - - - - - - - - - - X

The above named Plaintiff for its Complaint hereby alleges as follows:

1. This is an action arising under the Internal Revenue Laws of the United States, of which this Court has jurisdiction pursuant to Title 28, United States Code, Section 1340(a)(1).

2. Plaintiff is a corporation duly organized and existing under the laws of Delaware, and maintains its principal office at 60 Wall Street, New York City, New York.

3. This action is brought for an overpayment of Federal income tax for the taxable years ended December 31, 1953 and 1954 in the respective amounts of $422,160.18,

and $569,033.49, or in the alternative $1,225,691.89 and $1,261,071.49, or such further amounts as may be legally refundable, together with statutory interest thereon.

4. At all times pertinent hereto, Plaintiff has kept its books and filed its Federal income tax returns on the accrual basis, utilizing a calendar year.

5. Plaintiff timely filed its consolidated Federal income tax return for the taxable year ended December 31, 1953 under date of September 15, 1954 with the District Director of Internal Revenue, Lower Manhattan District, New York.

6. Said return as filed disclosed a Federal income tax liability of $21,875,518.20, which was paid to the aforesaid District Director in the amounts and on the dates as set forth below:

Date of Payment	Amount of Tax
March 15, 1954	$10,766,679.00
June 15, 1954	10,766,679.00
December 15, 1954	342,160.20
Total	$21,875,518.20

7. On March 23, 1962 the then Commissioner of Internal Revenue made the following additional assessment

of income tax and interest thereon with respect to Plaintiff's taxable year ended December 31, 1953:

Tax	Interest
$736,596.63	$339,272.38

8. Said additional assessment was paid in full by Plaintiff on March 23, 1962 to the District Director of Internal Revenue, Manhattan District, New York.

9. Under date of March 24, 1964, Plaintiff timely filed with the District Director of Internal Revenue, Manhattan District, New York, a Claim For Refund (Form 843) for its taxable year ended December 31, 1953, in the amount of $139,201.10.

10. Plaintiff to date has had no formal notice of any action taken by Defendant, either allowing or disallowing said Claim For Refund of $139,201.10.

11. Inasmuch as more than six months have elapsed since the filing of said Claim For Refund, Plaintiff brings this action for its taxable year ended December 31, 1953 pursuant to the provisions of Section 6532(a)(1) of the Internal Revenue Code of 1954.

12. Plaintiff timely filed its consolidated Federal income tax return for the taxable year ended December 31,

1954 under date of September 14, 1955 with the District Director of Internal Revenue, Lower Manhattan District, New York.

13. Said return as filed disclosed a Federal income tax liability of $11,457,990.87, which was paid to the aforesaid District Director in the amounts and on the dates as set forth below:

Date of Payment	Amount of Tax
March 15, 1955	$ 5,750,000.00
June 15, 1955	5,750,000.00
Total	$ 11,500,000.00

14. On or about October 18, 1955, Plaintiff received from the aforesaid District Director a refund of tax in the amount of $42,009.13 together with interest thereon of $733.72 with respect to its taxable year ended December 31, 1954.

15. On or about October 25, 1961, Plaintiff filed with the District Director of Internal Revenue, Manhattan District, an amended consolidated Federal income tax return for its taxable year ended December 31, 1954, which reflected an additional tax due for such year in the amount of $75,085.30.

16. Plaintiff paid said additional tax of $75,035.30 on or about October 25, 1961, to the aforesaid District Director of Internal Revenue.

17. On or about November 23, 1962, the then Commissioner of Internal Revenue made the following additional assessment of income tax and interest thereon with respect to Plaintiff's taxable year ended December 31, 1954:

Tax	Interest
$ 783,271.95	$ 361,335.15

18. Said additional assessment was paid in full by Plaintiff on or about December 3, 1962, to the aforesaid District Director of Internal Revenue, Manhattan District, New York.

19. Under date of March 24, 1964, Plaintiff timely filed with the District Director of Internal Revenue, Manhattan District, a Claim For Refund (Form 843) for its taxable year ended December 31, 1954, in the amount of $200,035.69.

20. Under date of February 10, 1966, Plaintiff timely filed with the District Director of Internal Revenue, Manhattan District, an Amended Claim For Refund (Form 843) for its taxable year ended December 31, 1954, in the amount of $468,129.65.

21. On or about October 25, 1966, Plaintiff received from the District Director of Internal Revenue, Manhattan District, a refund of tax in the amount of $59,909.02, together with interest thereon of $48,002.75, with respect to its taxable year ended December 31, 1954.

22. Under date of November 17, 1966, Plaintiff received by certified mail from the District Director of Internal Revenue, Manhattan District, a Statutory Notification of the disallowance in full of its aforesaid Claim For Refund in the amount of $200,085.69, and Amended Claim For Refund in the amount of $468,129.65, as provided in Section 6532 of the Internal Revenue Code of 1954, and accordingly brings this action for its taxable year ended December 31, 1954, pursuant to the provisions of Section 7422 of the Internal Revenue Code of 1954.

Count I

23. At all times pertinent hereto, Plaintiff has been a registered holding company under the Public Utility Holding Company Act of 1935 (hereafter referred to as the "Act").

24. As such Plaintiff was required to file, and did file on November 20, 1946, with the Securities and Exchange Commission (hereafter referred to as the "Commission") a

Plan, pursuant to Section 11(e) of said Act, for the simplification of its corporate structure (hereafter referred to as the "Plan").

25. So far as material hereto, said Plan as amended on February 20, 1947, provided for the issuance by Plaintiff of $115,246,950 principal amount of its 3% Debentures due 1977 in exchange for all its outstanding preferred and preference capital stock.

26. Under date of April 24, 1947, an Order was issued by the Commission to Plaintiff to comply with the provisions of the Plan as amended, which Order recited that the issuance by Plaintiff of its aforesaid 3% Debentures in exchange for all its outstanding preferred and preference capital stock was necessary or appropriate to effectuate the provisions of Section 11(b) of the Act.

27. On May 27, 1947, the Plan became operative pursuant to an Order of Enforcement issued by the United States District Court for the District of Delaware.

28. On May 28, 1947, Plaintiff, in accordance with the Plan as amended, issued $115,246,950 aggregate principal amount of its 3% Sinking Fund Debentures due 1977 in exchange for all its issued and outstanding preferred and preference

shares, as of the effective date of the Plan, as set forth below:

Class of Stock:	Number of Shares	Principal Amount Debentures Per Share	Aggregate Principal Amount Debentures
$6 Preferred	560,600	$196.50	$110,157,900.00
$6 Preference BB	17,700	193.50	3,424,950.00
60¢ Preference B	86,000	19.35	1,664,100.00
			$115,246,950.00

29. The aforesaid 560,600 shares of $6 Preferred capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of such issuance of $44,967,026.15.

30. The aforesaid 17,700 shares of $6 Preference BB capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of such issuance of $1,048,181.35.

31. The aforesaid 86,000 shares of 60¢ Preference B capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of such issuance of $749,439.95.

32. The aggregate fair market value of Plaintiff's aforesaid 560,600 shares of $6 Preferred capital stock, 17,700 shares of $6 Preference BB capital stock, and 86,000 shares of 60¢ Preference B capital stock, exchanged for said 3% Debentures pursuant to said Plan, was no more than $84,459,215.52.

33. During the taxable year ended December 31, 1953, Plaintiff retired $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures through purchases on the open market of said Debentures for an aggregate purchase price of $1,398,357.39.

34. During the taxable year ended December 31, 1954 Plaintiff retired $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures through purchases on the open market of said Debentures for an aggregate purchase price of $1,786,569.02.

35. As the result of its retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1953, Plaintiff sustained a loss in the amount of no less than $781,778.11, such loss being a deductible expense for said taxable year.

36. In the alternative, as the result of its retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended Decem-

ber 31, 1953, Plaintiff sustained a loss in the amount of no less than $284,785.38, such loss being a deductible expense for said taxable year.

37. In determining Plaintiff's Federal income tax liability for the taxable year ended December 31, 1953, the Commissioner of Internal Revenue erroneously failed to allow Plaintiff any deduction for the aforesaid loss of $781,773.11, or, in the alternative, of $284,785.38, incurred upon the retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during said year.

38. As the result of its retirement of $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1954, Plaintiff sustained a loss in the amount of no less than $1,053,774.99, such loss being a deductible expense for said taxable year.

39. In the alternative, as the result of its retirement of $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1954, Plaintiff sustained a loss in the amount of no less than $463,107.55, such loss being a deductible expense for said taxable year.

40. In determining Plaintiff's Federal income tax liability for the taxable year ended December 31, 1954, the Commissioner of Internal Revenue failed to allow Plaintiff

any deduction for the aforesaid loss of $1,053,774.99, or, in the alternative, of $463,107.55, incurred upon the retirement of $1,305,900.00 aggregate principal amount of its aforesaid 3% Debentures during said year.

41. The actions of the Commissioner of Internal Revenue enumerated in paragraphs 37 and 40, supra, were erroneous, illegal and without warrant in law.

42. As the result of the facts set forth in this Count, there is due and owing from Defendant to Plaintiff for the taxable year ended December 31, 1953, the amount of $422,160.18, or, in the alternative, $153,784.11, and for the taxable year ended December 31, 1954, the amount of $369,038.49, or, in the alternative, $250,078.08, or such further amounts as this Court may find due and owing from Defendant to Plaintiff with interest thereon as provided by law.

Count II

43. Plaintiff repeats, reiterates and realleges paragraphs 1 through 34, inclusive, of this Complaint and incorporates such paragraphs herein by this reference.

44. By way of an alternative to the allegations set forth in Count I, paragraphs 35 through 42, supra, Plaintiff alleges its aforesaid 3% Debentures were issued at an

aggregate discount of no less than $68,482,302.55, said discount being ratably amortizable over the life of said Debentures.

45. By way of a further alternative, and as an alternative to the allegations set forth in Count I, supra, Plaintiff alleges its aforesaid 3% Debentures were issued at an aggregate discount of no less than $30,787,734.48, said discount being ratably amortizable over the life of said Debentures.

46. As the result of the discount sustained by Plaintiff on the issuance of its 3% Debentures under the alternative allegation set forth in paragraph 44, supra, Plaintiff was entitled to a deduction for the amortization thereof for the taxable years ended December 31, 1953 and 1954, as well as to a deduction for each of such years for the unamortized portion of said discount attributable to Plaintiff's retirements therein of $1,519,500.00 and $1,805,900.00 aggregate principal amount of its 3% Debentures, said deductions being no less than the amounts as set forth below:

Year	Amortization of Discount	Unamortized Discount Attributable to Retirements
1953	$ 1,537,289.46	$ 732,510.33
1954	1,501,015.46	834,302.11

47. In determining Plaintiff's Federal income tax liability for the taxable years ended December 31, 1953 and 1954, the Commissioner of Internal Revenue failed to allow any deductions for the amounts set forth in paragraph 46, supra.

48. As the result of the discount sustained by Plaintiff on the issuance of its 3% Debentures under the alternative allegation set forth in paragraph 45, supra, Plaintiff was entitled to a deduction for the amortization thereof for the taxable years ended December 31, 1953 and 1954, as well as to a deduction for each of such years for the unamortized portion of said discount attributable to Plaintiff's retirement therein of $1,519,500.00 and $1,805,900.00 aggregate principal amount of its 3% Debentures, said deductions being no less than the amounts as set forth below:

Year	Amortization of Discount	Unamortized Discount Attributable to Retirements
1953	$ 691,122.50	$ 329,316.23
1954	674,814.71	375,078.97

49. In determining Plaintiff's Federal income tax liability for the taxable years ended December 31, 1953 and 1954, the Commissioner of Internal Revenue failed to allow

any deductions for the amounts set forth in paragraph 48, supra.

50. The actions of the Commissioner of Internal Revenue enumerated in paragraphs 47 and 49, supra, were erroneous, illegal and without warrant in law.

51. As the result of the facts set forth in this Count, there is due and owing from Defendant to Plaintiff for the taxable year ended December 31, 1953, the amount of $1,225,691.89, or, in the alternative, $551,036.91, and for the taxable year ended December 31, 1954, the amount of $1,261,071.49, or, in the alternative, $566,942.59, or such further amounts as this Court may find due and owing from Defendant to Plaintiff with interest thereon as provided by law.

52. Although repayment of the said amounts set forth in paragraphs 42 and 51, supra, has been demanded in the alternative, no part thereof has been credited, remitted, refunded or repaid to Plaintiff or to anyone on Plaintiff's account.

WHEREFORE, Plaintiff demands judgment against Defendant in either of the alternative principal amounts as set forth in paragraph 42, supra, or, in the alternative, in

either of the alternative principal amounts as set forth in paragraph 51, supra, or such further amount as this Court may find to be legally due and owing by Defendant to Plaintiff, together with interest thereon as provided by law.

Robert J. Casey
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OF COUNSEL:

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Filed
5/31/67

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

CITIES SERVICE COMPANY,

Plaintiff,

-v-

UNITED STATES OF AMERICA,

Defendant.

ANSWER

67 Civ. 4606

Defendant, United States of America, by its attorney Robert M. Morgenthau, United States Attorney for the Southern District of New York for its answer to the complaint herein:

1. Admits each and every allegation contained in paragraph 1 of the complaint herein.

2. Admits, on information and belief, the allegations contained in paragraph 2 of the complaint herein.

3. With respect to the allegations contained in paragraph 3 of the complaint herein defendant denies that plaintiff overpaid any Federal Income Tax for the years ended December 31, 1953 and December 31, 1954 but admits that this action is brought to recover the sums mentioned in said paragraph 3 as overpayments.

4. Admits each and every allegation contained in paragraph 4 of the complaint herein.

5. Admits each and every allegation contained in paragraph 5 of the complaint herein.

6. Admits each and every allegation contained in paragraph 6 of the complaint herein.

7. Admits each and every allegation contained in paragraph 7 of the complaint herein.

8. Admits each and every allegation contained in paragraph 8 of the complaint herein.

9. Admits each and every allegation contained in paragraph 9 of the complaint herein.

10. Admits each and every allegation contained in paragraph 10 of the complaint herein.

11. With respect to the allegations contained in paragraph 11 of the complaint herein defendant admits that plaintiff purports to bring this action pursuant to the provisions of Section 6532(a)(1) of the Internal Revenue Code of 1954.but denies that plaintiff is entitled to any refund for the taxible year ended December 31, 1953.

12. Admits the allegations contained in paragraph 13 of the complaint herein.

13. Admits the allegations contained in paragraph 13 of the complaint herein.

14. Admits the allegations contained in paragraph 14 of the complaint herein.

15. Admits the allegations contained in paragraph 15 of the complaint herein.

16. Admits the allegations contained in paragraph 16 of the complaint herein.

17. Admits the allegations contained in paragraph 17 of the complaint herein.

18. Admits the allegations contained in paragraph 18 of the complaint herein.

19. Admits the allegations contained in paragraph 19 of the complaint herein.

20. Admits the allegations contained in paragraph 20 of the complaint herein.

21. Admits the allegations contained in paragraph 21 of the complaint herein.

22. With respect to the allegations contained in paragraph 22 of the complaint herein, defendant admits that plaintiff purports to bring this action pursuant to the provisions of Section 6532 of the Internal Revenue Code of 1954 but denies that plaintiff is entitled to any refund for the taxible year ended December 31, 1954.

23. Defendant denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 23 of the complaint herein.

24. With respect to the allegations contained in paragraph 24 of the complaint herein defendant denies that it has information sufficient to form a belief as to the truth or falsity of the allegation contained in said paragraph 24 that plaintiff was required to file a plan pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935 for the simplification of its corporate structure but admits the allegation in said paragraph 24 that plaintiff did file such a plan with the Securities and Exchange Commission on November 20, 1946.

25. Admits the allegations contained in paragraph 25 of the complaint herein.

26. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 26 of the complaint herein.

27. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 27 of the complaint herein.

28. Admits the allegations contained in paragraph 28 of the complaint herein.

29. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 29 of the complaint herein.

30. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 30 of the complaint herein.

31. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 31 of the complaint herein.

32. Denies that it has information sufficient to form a belief as to the truth or falsity of the allegations contained in paragraph 32 of the complaint herein.

33. Admits the allegations contained in paragraph 33 of the complaint herein.

34. Admits the allegations contained in paragraph 34 of the complaint herein.

35. Denies each and every allegation contained in paragraph 35 of the complaint herein.

36. Denies each and every allegation contained in paragraph 36 of the complaint herein.

37. With respect to the allegations contained in paragraph 37 of the complaint herein defendant admits that the Commissioner of Internal Revenue refused to allow

plaintiff any deduction for any loss with respect to retirement of any of its 3% debentures during the taxable year ended December 31, 1953, but denies that the Commissioner's action was in any way erroneous; denies that plaintiff ever claimed a refund for any loss with respect to the retirement of any bonds in the year ended December 31, 1953; and further denies that plaintiff sustained any loss with respect to the purchase of any of its 3% debentures during that year.

38. Denies each and every allegation contained in paragraph 38 of the complaint herein.

39. Denies each and every allegation contained in paragraph 39 of the complaint herein.

40. With respect to the allegations contained in paragraph 40 of the complaint herein defendant admits that the Commissioner of Internal Revenue refused to allow plaintiff any deduction for any loss with respect to retirement of any of its 3% debentures during the taxable year ended December 31, 1954, but denies that the Commissioner's action was in any way erroneous and further denies that plaintiff sustained any loss with respect to the purchase of any of its 3% debentures during that year.

41. Denies each and every allegation contained in paragraph 41 of the complaint herein.

42. Denies each and every allegation contained in paragraph 42 of the complaint herein.

43. With respect to the allegations contained in paragraph 43 of the complaint herein defendant respectfully refers to and incorporates its responses to the allegations incorporated by reference into said paragraph 43.

44. Denies each and every allegation contained in paragraph 44 of the complaint herein.

45. Denies each and every allegation contained in paragraph 45 of the complaint herein.

46. Denies each and every allegation contained in paragraph 46 of the complaint herein.

47. Admits the allegations contained in paragraph 47 of the complaint herein.

48. Denies each and every allegation contained in paragraph 48 of the complaint herein.

49. Admits the allegations contained in paragraph 49 of the complaint herein.

50. Denies each and every allegation contained in paragraph 50 of the complaint herein.

51. Denies each and every allegation contained in paragraph 51 of the complaint herein.

52. With respect to the allegations contained in paragraph 52 of the complaint herein, defendant denies that

plaintiff has demanded refund of the sums set forth in paragraphs 42 and 51 of the complaint herein; but admits that defendant has not credited, remitted or repaid any such sums to plaintiff.

AS AND FOR A FIRST PARTIAL AFFIRMATIVE DEFENSE

53. This Court lacks subject matter jurisdiction over Count I of the complaint herein insofar as that Count relates to the taxible year ended December 31, 1953 by reason of the fact that plaintiff never filed a claim for the refund of any amount as a loss in the purchase of any of its debentures in that year.

AS AND FOR A SECOND PARTIAL AFFIRMATIVE DEFENSE

54. This Court lacks subject matter jurisdiction over so much of plaintiff's claim with respect to the taxible year ended December 31, 1954 in Count I of the complaint herein as is based on the allegations contained in paragraphs 29, 30, 31 and 39 of the complaint herein by reason of the fact that plaintiff never filed a claim for refund on the theory raised in those paragraphs or for the amounts sought as a result thereof.

AS AND FOR A THIRD PARTIAL AFFIRMATIVE DEFENSE

55. This Court lacks subject matter jurisdiction over so much of plaintiff's claim in Count II of the complaint herein as seeks the recovery of any unamortized

discount attributable to its debentures retired in 1953 or 1954 as it never filed a claim for refund seeking the recovery of such unamortized discount.

AS AND FOR A FOURTH PARTIAL AFFIRMATIVE DEFENSE

56. This Court lacks subject matter jurisdiction over so much of plaintiff's claims with respect to the taxible years ended December 31, 1953 and December 31, 1954 in Count II of the complaint herein as are based in the allegations set forth in paragraphs 44 and 45 of said complaint since plaintiff never filed any claim for refund on the theories raised in those paragraphs or for the amounts sought as a result thereof.

WHEREFORE, defendant, United States of America demands judgement in its favor dismissing the complaint herein, awarding defendant the costs and disbursements of this action; and, awarding defendant such other and further relief as may be proper in the premises.

Dated: New York, New York
May , 1968.

ROBERT M. MORGENTHAU
United States Attorney for the
Southern District of New York
Attorney for Defendant

By: _____
BRIAN J. GALLAGHER
Assistant U. S. Attorney
Office and Post Office Address:
United States Courthouse
Foley Square
New York, New York 10007
Tel: 264-6322

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CITIES SERVICE COMPANY

PLAN PURSUANT TO SECTION 11(e) OF PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 FOR SIMPLIFICATION OF CORPORATE STRUCTURE

November 20, 1946

As Amended on February 20, 1947

PLAN FOR SIMPLIFICATION OF THE CORPORATE STRUCTURE

of

CITIES SERVICE COMPANY

(Submitted under Section 11(e) of Public Utility Holding Company Act of 1935)

PART I—Preliminary Statement

Cities Service Company (hereinafter called "Cities") is a corporation organized under the laws of Delaware and is a registered holding company under the Public Utility Holding Company Act of 1935 (hereinafter called the "Act").

At October 31, 1946, the funded debt and capital stock of Cities outstanding in the hands of the public were as follows:

5% Convertible Gold Debentures, due 1950	$40,578,100
5% Gold Debentures, due 1958	25,840,500
5% Gold Debentures, due 1963	5,125,000
Refunding 5% Gold Debenture Bonds, due 1966	9,618,700
5% Gold Debentures, due 1969	19,326,000
Preferred Stock $6 Cumulative, no par, 560,600 shares	56,060,000*
Preference BB Stock $6 Cumulative, no par, 17,700 shares	1,770,000*
Preference B Stock 60¢ Cumulative, no par, 86,000 shares	860,000*
Common Stock ($10 par value) 3,702,000 shares	37,020,000

* Stated Value.

The Preferred Stock $6 Cumulative (hereinafter called the "Preferred Stock") is preferred as to dividends over the Preference BB Stock (hereinafter called the "BB Stock"), the Preference B Stock (hereinafter called the "B Stock"), and the Common Stock; and the BB Stock and B Stock, ranking pari passu, are preferred as to dividends over the Common Stock.

On liquidation, dissolution or winding up of Cities, whether voluntary or involuntary, the Preferred Stock is entitled to receive $100 per share plus unpaid accrued dividends before any distribution is made to other stockholders, and the BB Stock and B Stock are entitled to receive $100 per share and $10 per share respectively, plus unpaid accrued dividends, before any distribution is made to the Common Stock.

The Preferred Stock, BB Stock and B Stock are subject to redemption, in whole or in part, at any time, by payment of an amount equal to $112, $106 and $10.60 per share respectively, plus unpaid accumulated dividends.

At October 31, 1946, unpaid accumulated dividends on the Preferred Stock amounted to $46,810,100 ($83.50 per share); on the BB Stock, $1,531,050 ($86.50 per share); and on the B Stock, $743,900 ($8.65 per share).

Impact of the Act on Cities' System

Cities Service Power & Light Company (hereinafter called "Power & Light"), the major utility holding company in the Cities' system, with nation-wide interests in electric and gas utility companies, was required by orders of the Securities and Exchange Commission (hereinafter called the "Commission") issued under Section 11(b)(1) of the Act, dated respectively August 17, 1943 and August 18, 1944, to dispose of its interests in all of its properties except those located in Ohio.

Prior to August 30, 1946, pursuant to such orders, Power & Light had disposed of all of its properties, except its ownership of the common stock of The Ohio Public Service Company and of approximately 98% of the common stock of The Toledo Edison Company (electric light and power companies serving an important and highly industrialized area of Ohio, including the cities of Toledo, Warren, Mansfield, Elyria, Marion and Alliance); approximately 64% of the common stock of Federal Light & Traction Company (a holding company, expected to be presently dissolved, whose principal assets are cash and all the common stock of Public Service Company of New Mexico, a utility, principally electric, serving the cities of Albuquerque, Santa Fe, Las Vegas and Deming, New Mexico), and the common stock of Spokane Gas and Fuel Company (a utility serving manufactured gas to consumers in Spokane, Washington). On August 30, 1946, Power & Light was dissolved and Cities acquired its holdings in the companies above mentioned.

Cities itself is subject to an order of the Commission issued under Section 11(b)(1) of the Act, dated May 5, 1944, which as modified and clarified by supplemental order dated October 12, 1944, approves the decision of Cities to remain in the oil, wholesale natural gas and other non-utility businesses, and provides that it may comply with the requirements of Section 11(b)(1) by disposing of its utility properties. Pursuant to such orders Cities expects to dispose of its interests in the utility companies which it acquired on the dissolution of Power & Light, and also to secure adoption of such plan for compliance with the Act by Arkansas Natural Gas Corporation and subsidiaries as will cause the holdings of Cities therein to be non-utility investments.

When this has been accomplished, the only remaining utility companies in which Cities will have an interest will be The Gas Service Company (a natural gas distributing company serving Kansas City and adjacent areas), The Dominion Natural Gas Company (a gas producing, transporting and distributing company operating exclusively in Canada) and Republic Light, Heat and Power Company (a small natural gas producing and distributing company in New York, all the securities of which are owned by Cities); and Cities will, pursuant to the provisions of the Act, apply to the Commission for the right to continue its holdings in such companies but to be exempted from all the provisions of the Act.

Principal Holdings of Cities to be Retained*

	No. Shares of Outstanding Common Stock	Per Cent of Outstanding Common Stock Owned by Cities or one of its Subsidiaries
OIL AND WHOLESALE NATURAL GAS:		
Empire Gas and Fuel Company (holding company)	418,000	100%
Cities Service Gas Company (natural gas producing and transportation)	284,000	100%
Cities Service Oil Company (Delaware) (oil producing, refining and marketing)	736,500	100%
Empire Pipeline Company (oil pipe line)	45,000	100%
Cities Service Oil Company, Limited (oil marketing)	3,500	100%
Richfield Oil Corporation (oil producing, refining and marketing)	1,257,977	31.371%
Natural Gas Pipeline Company of America (natural gas pipe line)	428,429	28.562%
Texoma Natural Gas Company (natural gas producing and pipe line)	2,856	28.562%
The Texas-Empire Pipe Line Company (oil pipe line)	60,000	50%
Cities Service Oil Company (Pennsylvania) (oil transportation and marketing)	90,000	100%
Cities Service Refining Corporation (oil refining)	240,000	100%
Arkansas Natural Gas Corporation (holding company)	3,916,379	51.5%**
Arkansas Fuel Oil Company (oil producing and marketing)	102,019	100%
Arkansas Pipeline Corporation (oil pipe line)	2,142	100%
Orange State Oil Company (oil marketing)	994,093	100%

	No. Shares of Outstanding Common Stock	Per Cent of Outstanding Common Stock Owned by Cities or one of its Subsidiaries
REAL ESTATE:		
Sixty Wall Tower, Inc. (owning 70 Pine St., N. Y.)	1,000	100%
Sixty Wall Street (owning 60 Wall St., N. Y., 52 Wall St., N. Y., 54 Wall St., N. Y.)	10,000	100%
UTILITIES:		
The Gas Service Company (natural gas distribution)	850,000	100%
Republic Light, Heat and Power Company, Inc. (natural gas production and distribution)	33,746	100%
Dominion Natural Gas Company, Limited (natural gas producing, transporting and marketing)	60,846	100%

* The above list does not include all the companies in which Cities has interests, nor does it include all the holdings of Cities in the companies above named, in some of which Cities has important holdings of securities senior to the Common Stock.

** Includes both Common and Class A Stock. Cities also owns $8,708,120 par value out of $21,879,261.90 par value outstanding of preferred stock of this company.

PART II—Terms of the Plan

1. Retirement of $40,578,100 outstanding Convertible Gold Debentures, due 1950

Immediately upon the Plan becoming effective, Cities will call for redemption and, in accordance with indenture provisions, redeem and retire, out of its treasury cash, all of its outstanding 5% Convertible Gold Debentures, due 1950, aggregating as of October 31, 1946, $40,578,100 in principal amount. This will reduce the outstanding funded debt to $59,910,200.

2. Retirement of Remaining $59,910,200 outstanding Debentures

Although the Plan does not provide for the retirement of said remaining outstanding debentures of Cities immediately upon the Plan becoming effective, it is anticipated that the proceeds to be derived by Cities from the disposition of its interest in the utility companies which it acquired on the dissolution of Power & Light will be more than sufficient to effectuate such retirement and, as set forth in subdivision 4 of the Plan, Cities will covenant to apply such proceeds, as and when realized, to the retirement of its remaining presently outstanding funded debt.

3. Issue of Debentures in Exchange for Preferred, BB and B Stock

Cities will issue in exchange for the outstanding Preferred Stock, BB Stock and B Stock and all rights appertaining thereto, including all arrears thereon, its 3% Sinking Fund Debentures (hereinafter called "Debentures") in an aggregate principal amount equal in each case to the sum of the stated value, arrears to December 31, 1946 and call premium (in all aggregating $115,246,950) as follows:

	Principal Amount of Debentures to be Issued
For every share of Preferred Stock (including all arrears)	$196.50
For every share of BB Stock (including all arrears)	193.50
For every share of B Stock (including all arrears)	19.35

4. Description of Debentures

The Debentures will bear interest at the rate of 3% per annum from January 1, 1947, will be dated January 1, 1947, and will mature on January 1, 1977. Interest will be payable semi-annually on July 1 and January 1. They will be redeemable as a whole at any time, or in part from time to time, upon payment of the principal amount plus accrued unpaid interest. They will be issued under an Indenture which will provide:

(a) A sinking fund which will effect the retirement of $1,500,000 principal amount of Debentures annually;

(b) That the proceeds of the disposition by Cities of its interests in The Ohio Public Service Company, The Toledo Edison Company, Federal Light & Traction Company and Spokane Gas and Fuel Company shall be applied to the retirement of the $59,910,200 principal amount of its remaining

outstanding funded debt mentioned in subdivision 2 of the Plan, and any excess of such proceeds to the partial retirement of the Debentures; and that pending the retirement of said $59,910,200 of outstanding funded debt of Cities the Debentures shall be subordinate thereto;

(c) That while any of the Debentures are outstanding, subject to certain exceptions specified in the Indenture, Cities will not mortgage or pledge any securities at any time owned by it without either (1) securing the Debentures outstanding ratably with all indebtedness secured by such mortgage or pledge, or (2) increasing the sinking fund for the Debentures in each year during the existence of such secured indebtedness by 2% of the principal amount of such secured indebtedness outstanding during such year;

(d) That while any of the Debentures are outstanding Cities will not create or assume any funded indebtedness, and will not permit any subsidiary of which it owns 95% or more of the voting securities to create or assume any funded indebtedness or issue or sell any of its stock, (except in either case to be held by Cities or a subsidiary and except for certain refunding purposes as specified in the Indenture) unless the consolidated income of Cities and subsidiaries (before provision for taxes on income and for the consolidated interest and other charges hereinafter mentioned) for a defined 12 months' period shall be equal to at least twice the aggregate of the consolidated interest charges, subsidiary companies' preferred dividends and minority interest in income for said period, all as more particularly set forth in the Indenture;

(e) That while any of the Debentures are outstanding Cities will not declare or pay any cash dividends on its common stock except out of its earned surplus accumulated subsequent to December 31, 1946, as more particularly defined and set forth in the Indenture.

The Debentures are to be issued in coupon form (registerable as to principal only) and in fully registered form without coupons in the denominations of $1,000, $500 and $100, and in case of fully registered bonds in denominations of multiples of $1,000. Interim Certificates will be issued in denominations of $10 or multiples thereof for amounts less than $100, which when combined in the requisite amount may, at any time prior to January 1, 1950, be exchanged for one or more Debentures of an authorized denomination. Amounts less than $10 will be paid in cash at par.

5. Miscellaneous

Upon the entry of the order of the court hereinafter referred to, directing action to be taken to carry out the terms and provisions of the Plan, all rights of the holders of the Preferred Stock, BB Stock and B Stock, except to receive Debentures, Interim Certificates and cash pursuant to the Plan, shall cease and determine; and the right of holders of such stock to receive Debentures, Interim Certificates and cash under the Plan must be exercised on or before January 1, 1950, after which date such right shall likewise cease and determine. Promptly after January 1, 1950 Cities will sell the Debentures theretofore issuable to the holders of all the shares of Preferred Stock, BB Stock and B Stock not theretofore exchanged for Debentures under the Plan, and the respective holders of such unexchanged stock will thereafter have the right to receive their pro rata amounts of the proceeds of such sale upon surrender of the certificates representing their stock at any time prior to January 1, 1953, after which date any of such moneys not theretofore collected by such holders will revert to Cities.

Cities will arrange, without cost to the holders thereof, for the sale or purchase of Interim Certificates at market prices prevailing for the Debentures and, promptly after January 1, 1950 Cities will sell the Debentures for which all Interim Certificates then outstanding are exchangeable, and the respective holders of such unexchanged Interim Certificates will thereafter have the right to receive their pro rata amounts of the proceeds of such sale upon the surrender of their Interim Certificates at any time prior to January 1, 1953, after which date any of such moneys not theretofore collected by such holders will revert to Cities.

Cities will pay such fees and expenses for services rendered in connection with the Plan as may be allowed by the Commission.

PART III.—Conditions to Effectuation of Plan

The effectuation of the Plan is subject to the following conditions:

1. The Plan shall have been found by the Commission to be necessary or appropriate to effectuate the provisions of Section 11(b) of the Act and to be fair and equitable to all the persons affected thereby and all actions requisite to the consummation of the Plan shall have been approved by order of the Commission.

2. The Commission shall have instituted a proceeding in a court of competent jurisdiction pursuant to Section 11(e) of the Act and such court shall have entered an order finding the Plan to be fair and equitable and necessary or appropriate to effectuate the provisions of Section 11 of the Act and directing action to be taken to carry out the terms and provisions of the Plan.

3. The order of the Commission shall recite that the transactions of the Plan are necessary or appropriate to the simplification of the structure of the holding company system of which Cities is a member and necessary or appropriate to effectuate the provisions of Section 11(b) of the Act, all in accordance with the meaning and requirements of the Internal Revenue Code, as amended, including Section 1808(f) and Supplement R thereof.

4. Any corporate action in connection with the Plan which may be deemed necessary by counsel for Cities shall have been carried out in a manner satisfactory to counsel for Cities.

PART IV—Amendments to the Plan and Other Provisions

Until approved by the Commission, the Plan or any part thereof may be modified or amended in any respect by Cities. After being approved by the Commission and before being approved by a Court, the Plan or any part thereof may be amended in any respect by Cities with the approval of the Commission. After the approval by the Court and before it has been consummated the Plan may be modified or amended in any respect by Cities with the approval of both the Commission and the Court. No amendments to the Plan or any part thereof shall be made without the approval or consent of Cities.

In the opinion of counsel for Cities, under the provisions of the present Internal Revenue laws, the exchange of Preferred Stock for new Debentures pursuant to the Plan will not result in a taxable gain or loss to the holders of such Preferred Stock.

There are annexed hereto the following financial statements of Cities:

Exhibit A—Balance sheet as at October 31, 1946 and income statement for the 12 months ended October 31, 1946, actual and pro forma giving effect to the consummation of the Plan.

Exhibit B—Pro forma balance sheet as at October 31, 1946 and pro forma income statement for the 12 months ended October 31, 1946, giving effect not only to the consummation of the Plan but also giving effect in addition to the disposition of Cities' interests in certain utility companies and the application of the proceeds thereof to the retirement of funded debt as provided in the Plan.

The financial and other statements, the opinions and estimates contained in the Plan and Exhibits thereto are intended for the purpose of assisting stockholders, the Commission and Courts in proceedings with respect to the Plan and are not intended for use or information by prospective purchasers of securities of Cities or of any of the companies mentioned in the Plan.

All reported figures not previously audited are subject to any adjustments which the annual audit may disclose to be necessary. Cities does not, by publishing the information contained therein, intend to make any representation whatever as to the value of any assets shown in the balance sheets.

This Plan is filed without waiver and with full reservation of all constitutional and legal rights of Cities and its subsidiaries to contest the validity and legality of any section or any subdivision of any section of, or any order, rule or regulation under the Act.

CITIES SERVICE COMPANY

By W. Alton Jones
President

February 20, 1947.

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FINANCIAL STATEMENTS

EXHIBIT A

Giving Effect to Consummation of the Plan

CITIES SERVICE

BALANCE SHEET—ACTUA

As of October

Giving effect to consummation of the plan for
(Subject to year-end

ASSETS	Actual	Pro Forma Adjustments*	Pro Forma
INVESTMENTS AND ADVANCES:			
Subsidiary companies, other than public utilities:			
Securities—at cost or less	$167,997,476.44	$ ----------	$167,997,476.44
Public utilities, including Arkansas Natural Gas Corporation:			
Securities—at cost or less	61,051,187.35	----------	61,051,187.35
Advances	7,477,866.97	----------	7,477,866.97
Other investments and advances—at cost, less reserve	360,355.72	----------	360,355.72
Total Investments and Advances	236,886,886.48	----------	236,886,886.48
OFFICE FURNITURE AND FIXTURES—at cost, less reserve	26,851.19	----------	26,851.19
CASH IN DEBENTURE PURCHASE FUND	130,395.63	----------	130,395.63
CURRENT ASSETS:			
Cash in banks and on hand	85,755,820.82	{R 43,520,734.74(2)} {R 450,000.00(4)}	41,785,086.08
Securities of United States Government	3,025,000.00	----------	3,025,000.00
Dividends and accrued interest on securities owned	121,317.23	----------	121,317.23
Accounts receivable	49,846.98	----------	49,846.98
Total Current Assets	88,951,985.03	R 43,970,734.74	44,981,250.29
OTHER ASSETS—Accounts and notes receivable (not current)	20,609.94	----------	20,609.94
DEFERRED CHARGES:			
Unamortized debenture discount and expense	3,198,481.62	R 505,712.05(3)	2,692,769.57
Other deferred charges	8,331.89	----------	8,331.89
Total Deferred Charges	3,206,813.51	R 505,712.05	2,701,101.46
	$329,223,541.78	$R 44,476,446.79	$284,747,094.99

See a companying notes

* Figures in parentheses refer to pro forma adjustment entries.

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EXHIBIT A-1
Page 1

COMPANY

L AND PRO FORMA

31, 1946

simplification of the corporate structure
adjustments)

LIABILITIES	Actual	Pro Forma Adjustments*	Pro Forma
CAPITAL STOCK, per schedule attached:			
Preferred and preference stocks	$ 58,690,000.00	$R 58,690,000.00(1)	$ -------
Common stock	37,020,000.00	-------	37,020,000.00
Total Capital Stock	95,710,000.00	R 58,690,000.00	37,020,000.00
5% DEBENTURES OF VARIOUS MATURITIES DUE 1950 TO 1969, per schedule attached	100,488,300.00	R 40,578,100.00(2)	59,910,200.00
PROPOSED 3% DEBENTURES DUE JANUARY 1, 1977	-------	115,246,950.00(1)	115,246,950.00
CURRENT LIABILITIES (exclusive of requirements in respect of debentures):			
Accounts payable to subsidiary companies	25,432.44	-------	25,432.44
Other accounts payable	981,719.13	-------	981,719.13
Accrued interest on debentures ($1,194,251.65) and unpresented coupons ($11,840,550.53) —actual	13,034,802.18	R 2,131,072.74(2)	10,903,729.44
Accrued taxes and other charges	522,251.19	-------	522,251.19
Provision for Federal taxes on income	265,639.64	R 17,500.00(3)	248,139.64
Total Current Liabilities	14,829,844.58	R 2,148,572.74	12,681,271.84
RESERVES:			
Accrued undeclared cumulative dividends on preferred and preference stocks to December 31, 1937	19,661,150.00	R 19,661,150.00(1)	-------
Contingencies	6,691,905.47	-------	6,691,905.47
	26,353,055.47	R 19,661,150.00	6,691,905.47
CAPITAL SURPLUS	22,580,395.68	-------	22,580,395.68
EARNED SURPLUS (since December 31, 1937)	69,261,946.05	R 36,895,800.00(1) R 811,562.00(2) R 488,212.05(3) R 450,000.00(4)	30,616,372.00
	$329,223,541.78	$R 44,476,446.79	$284,747,094.99

to financial statements.

CITIES SERVICE COMPANY

NOTES TO FINANCIAL STATEMENTS

As of October 31, 1946

(1) Cumulative dividends on the $6.00 Preferred, $6.00 Preference BB and 60¢ Preference B Stocks are in arrears to the extent of $83.50, $86.50 and $8.65 per share, respectively, or $49,085,050.00 in the aggregate. At October 31, 1946, the Company carried a reserve of $19,661,150.00 for such dividends in arrears to December 31, 1937. Earned surplus subject to balance of accumulated dividends in aggregate amount of $29,423,900.00.

(2) Cities Service Company has guaranteed performance contracts between two of its subsidiaries and agencies of the United States Government. In connection with one of these subsidiaries Cities Service Company has also (a) guaranteed the repayment of $9,647,588.64 of the loans made by Reconstruction Finance Corporation to such subsidiary and (b) undertaken to advance such subsidiary such amounts as may be required by the latter under its guaranty of bank credit of $1,000,000.00 extended to a building contractor.

FUNDED DEBT

	Outstanding	In Treasury	In Hands of Public
Refunding 5% Gold Debenture Bonds due 1966	$ 9,618,800.00	$ 100.00	$ 9,618,700.00
5% Gold Debentures due 1958	34,652,000.00	8,811,500.00	25,840,500.00
5% Gold Debentures due 1963	23,930,000.00	18,805,000.00	5,125,000.00
5% Gold Debentures due 1969	37,356,000.00	18,030,000.00	19,326,000.00
5% Convertible Gold Debentures due 1950	58,685,700.00	18,107,600.00	40,578,100.00
Total	$164,242,500.00	$ 63,754,200.00	$100,488,300.00

CAPITAL STOCK

Preferred Stock, $6.00 Cumulative—no par value:	
Authorized, 1,500,000 shares; Issued, 560,920 shares, less in treasury, 320 shares	$ 56,060,000.00
Preference BB Stock, $6.00 Cumulative—no par value:	
Authorized, 600,000 shares; Issued, 17,700 shares	1,770,000.00
Preference B Stock, 60¢ Cumulative—no par value:	
Authorized, 4,000,000 shares; Issued, 86,000 shares	860,000.00
	58,690,000.00
Common Stock—$10.00 par value:	
Authorized, 5,000,000 shares; Issued, 3,703,977.6 shares, less in treasury, 1,977.6 shares	37,020,000.00
Total	$ 95,710,000.00

CITIES SERVICE COMPANY

BALANCE SHEET—PRO FORMA ADJUSTMENT ENTRIES

As of October 31, 1946

To give effect to consummation of the plan for simplification of the corporate structure

	Debit	Credit
(1)		
Capital Stock:		
$6.00 Cumulative Preferred	$56,060,000.00	
$6.00 Cumulative Preference BB	1,770,000.00	
60¢ Cumulative Preference B	860,000.00	
	58,690,000.00	
Reserve for accrued undeclared cumulative dividends on preferred and preference stocks to December 31, 1937	19,661,150.00	
Earned Surplus	36,895,800.00	
Proposed 3% Debentures Due January 1, 1977		$115,246,950.00
To reflect the issue of new 3% Debentures Due January 1, 1977 in consideration of the cancellation and retirement of all of the preferred and preference stocks of Cities Service Company. Earned surplus is being charged with (1) an amount equal to the aggregate of the call premiums on the preferred and preference stocks ($6,885,000) and (2) an amount equal to the accumulated and unpaid dividends on the preferred and preference stocks from January 1, 1938 to December 31, 1946 ($30,010,800). The amount of accumulated unpaid dividends applicable to the period prior to December 31, 1937 is being charged to reserve account heretofore provided for same.		
(2)		
5% Debentures Due 1950	40,578,100.00	
Accrued interest on debentures	2,131,072.74	
Earned Surplus	811,562.00	
Cash in banks and on hand		43,520,734.74
To reflect proposed call of all outstanding 5% Debentures due 1950 at principal amount plus two per cent premium together with accrued unpaid interest ($845,377.07) and unpresented coupons ($1,285,695.67) to October 31, 1946 and to charge Earned Surplus with total premium paid ($811,562).		
(3)		
Provision for Federal taxes on income	17,500.00	
Earned Surplus	488,212.05	
Unamortized debenture discount and expense		505,712.05
To reflect write off to Earned Surplus of unamortized debenture discount and expense balance (less amount equal to Federal income tax reduction applicable thereto—$17,500) relating to retirement of 5% Debentures due 1950.		
(4)		
Earned Surplus	450,000.00	
Cash in banks and on hand		450,000.00
To reflect estimated cash disbursements for expenses in connection with plan.		

CITIES SERVICE COMPANY

INCOME STATEMENT—ACTUAL AND PRO FORMA

For the Twelve Months Ended October 31, 1946

Giving effect to consummation of the plan for simplification of the corporate structure
(Subject to year-end adjustments)

	Actual	Pro Forma Adjustments*	Pro Forma
GROSS INCOME:			
Interest on bonds and indebtedness of subsidiary companies	$ 5,142,544.43	$	$ 5,142,544.43
Dividends on preferred and common stocks of subsidiary companies	12,598,626.02	.....	12,598,626.02
Interest and dividends on other investments	1,840,750.82	.....	1,840,750.82
Interest on notes and accounts receivable; and sundry receipts	4,663.57	.....	4,663.57
TOTAL GROSS INCOME	19,586,584.84	.....	19,586,584.84
EXPENSES:			
Administrative and management expenses	1,306,141.92	.....	1,306,141.92
General, legal and other expenses	1,210,592.33	.....	1,210,592.33
Taxes, other than taxes on income	201,766.62	.....	201,766.62
Depreciation of furniture and fixtures	60,000.00	.....	60,000.00
TOTAL EXPENSES	2,778,500.87	.....	2,778,500.87
	16,808,083.97	.....	16,808,083.97
INTEREST AND OTHER CHARGES:			
Interest on 5% debentures	6,084,103.44	R 3,074,662.40(1)	3,009,441.04
Interest on proposed 3% debentures	.....	3,457,408.50(4)	3,457,408.50
Amortization of debenture discount and expense	380,324.00	R 215,296.36(2)	165,027.64
Federal and State taxes on debentures interest coupons	117,995.59	R 79,574.38(3)	38,421.21
Provision for impairment of investment in a subsidiary company	745,000.00	.....	745,000.00
TOTAL INTEREST AND OTHER CHARGES	7,327,423.03	87,875.36	7,415,298.39
	9,480,660.94	R 87,875.36	9,392,785.58
PROVISION FOR FEDERAL INCOME TAX	318,000.00	R 3,500.00(5)	314,500.00
SPECIAL CHARGE equivalent to estimated reduction of Federal income tax applicable to call premium and other costs on retired securities	54,000.00	.....	54,000.00
	372,000.00	R 3,500.00	368,500.00
NET INCOME	$ 9,108,660.94	$R 84,375.36	$ 9,024,285.58
Times interest and other charges earned	2.29		2.27

* Figures in parentheses refer to pro forma adjustments.

CITIES SERVICE COMPANY

INCOME STATEMENT—EXPLANATION OF PRO FORMA ADJUSTMENTS

For the Twelve Months Ended October 31, 1946

To give effect to consummation of the plan for simplification of the corporate structure

(1) Elimination of interest expense on 5% debentures due 1950 for the twelve months ending October 31, 1946	$3,074,662.40
(2) Elimination of amortization charge on 5% debentures due 1950 for the twelve months ending October 31, 1946	215,296.36
(3) Elimination of Federal and State taxes assumed on 5% debentures due 1950	79,574.38
(4) Annual interest expense on proposed 3% debentures due 1977	3,457,408.50
(5) Decrease in Federal income tax expense in respect of foregoing adjustments	3,500.00

EXHIBIT A-3

CITIES SERVICE COMPANY

SURPLUS ACCOUNTS

For the Twelve Months Ended October 31, 1946

(Subject to year-end adjustments)

EARNED SURPLUS (Since December 31, 1937)

Balance October 31, 1945	$39,055,128.77
Net Income for the twelve months ended October 31, 1946	9,108,660.94
Net Profit on securities redeemed or sold	601,418.77
Surplus, accumulated subsequent to December 31, 1937, received upon liquidation of subsidiary companies	22,007,141.22
Unamortized discount and expense applicable to debentures of Cities Service Company acquired December 1945	R 218,060.82
Call premium, unamortized discount and expense and other costs relative to redemption of $35,000,000 principal amount 5% Debentures due 1950 on June 1, 1946 (less estimated reduction in applicable Federal income tax $54,000)	R 1,292,342.83
Balance October 31, 1946	$69,261,946.05

CAPITAL SURPLUS

Balance October 31, 1945	$22,373,760.78
Excess provision for Federal income taxes for period prior to December 31, 1937	16,738.06
Surplus, accumulated prior to December 31, 1937, received upon liquidation of subsidiary companies	7,179,478.92
Recovery on claims and other credits applicable to period prior to December 31, 1937	2,981.97
Premium on preferred and common stock reacquired, less accrued undeclared cumulative dividends on preferred stock to December 31, 1937	R 27,138.53
Surplus received on liquidation of a subsidiary company applied to Investment Account	R 6,965,425.52
Balance October 31, 1946	$22,580,395.68

EXHIBIT B

Giving Effect to Sale of Certain Utilities and the Application of Proceeds to Retirement of Debentures

CITIES SERVICE

PRO FORMA BALA

As of October

Giving effect to the consummation of the plan of simplificati
in addition, adjusted to reflect sale of certain public utility co
proceeds to the retirement of the remaining 5% outstanding
new debent

(Subject to year-end

ASSETS	Pro Forma Per Exhibit A-1	Pro Forma Adjustments*	Pro Forma
INVESTMENTS AND ADVANCES:			
Subsidiary companies, other than public utilities:			
Securities—at cost or less	$167,997,476.44	$ ----------	$167,997,476.44
Public utilities, including Arkansas Natural Gas Corporation:			
Securities—at cost or less	61,051,187.35	R 34,026,958.42(1)	27,024,228.93
Advances	7,477,866.97	----------	7,477,866.97
Other investments and advances—at cost, less reserve	360,355.72	R 14,000.00(1)	346,355.72
Total Investments and Advances	236,886,886.48	R 34,040,958.42	202,845,928.06
OFFICE FURNITURE AND FIXTURES—at cost, less reserve	26,851.19	----------	26,851.19
CASH IN DEBENTURE PURCHASE FUND	130,395.63	R 130,395.63(4)	----------
CURRENT ASSETS:			
Cash in banks and on hand	41,785,086.08	85,000,000.00(1) R 97,797,547.94(2) 130,395.63(4)	29,117,933.77
Securities of United States Government	3,025,000.00	----------	3,025,000.00
Dividends and accrued interest on securities owned	121,317.23	----------	121,317.23
Accounts receivable	49,846.98	----------	49,846.98
Total Current Assets	44,981,250.29	R 12,667,152.31	32,314,097.98
OTHER ASSETS—Accounts and notes receivable (not current)	20,609.94	----------	20,609.94
DEFERRED CHARGES:			
Unamortized debenture discount and expense	2,692,769.57	R 2,692,769.57(3)	----------
Other deferred charges	8,331.89	----------	8,331.89
Total Deferred Charges	2,701,101.46	R 2,692,769.57	8,331.89
	$284,747,094.99	$R 49,531,275.93	$235,215,819.06

* Figures in parentheses refer to pro forma adjustment entries.

A 41a

EXHIBIT B-1
Page 1

COMPANY

NCE SHEET

31, 1946

on of the corporate structure (see Exhibit A-1) and, ompanies and the application of estimated $85,000,000 debentures and $25,000,000 principal amount of the ures

adjustments)

LIABILITIES	Pro Forma Per Exhibit A-1	Pro Forma Adjustments*	Pro Forma
COMMON STOCK	$ 37,020,000.00	$ ----------	$ 37,020,000.00
5% DEBENTURES OF VARIOUS MATURITIES DUE 1958 to 1969	59,910,200.00	R 59,910,200.00(2)	----------
PROPOSED 3% DEBENTURES DUE JANUARY 1, 1977	115,246,950.00	R 25,000,000.00(2)	90,246,950.00
CURRENT LIABILITIES (exclusive of requirements in respect of debentures):			
Accounts payable to subsidiary companies	25,432.44	----------	25,432.44
Other accounts payable	981,719.13	----------	981,719.13
Accrued interest on debentures and unpresented coupons	10,903,729.44	R 10,903,729.44(2)	----------
Accrued taxes and other charges	522,251.19	----------	522,251.19
Provision for Federal taxes on income	248,139.64	R 165,000.00(3)	83,139.64
Total Current Liabilities	12,681,271.84	R 11,068,729.44	1,612,542.40
RESERVE FOR CONTINGENCIES	6,691,905.47	----------	6,691,905.47
CAPITAL SURPLUS	22,580,395.68	----------	22,580,395.68
EARNED SURPLUS (since December 31, 1937)	30,616,372.00	50,959,041.58(1) R 1,983,618.50(2) R 2,527,769.57(3)	77,064,025.51
	$284,747,094.99	$R 49,531,275.93	$235,215,819.06

CITIES SERVICE COMPANY

PRO FORMA BALANCE SHEET ADJUSTMENT ENTRIES

As of October 31, 1946

To give effect to sale of certain public utility companies and the application of estimated $85,000,000 proceeds to the retirement of the remaining 5% outstanding debentures and $25,000,000 principal amount of the new debentures

	Debit	Credit
(1)		
Cash in banks and on hand	$85,000,000.00	
Investments and Advances—Public utilities—Securities		$34,026,958.42
Other investments and advances		14,000.00
Earned Surplus		50,959,041.58
To reflect estimated proceeds from sale of securities of the undernoted public utility subsidiary companies and to remove from Investment account net carrying value thereof and to credit Earned Surplus with excess of proceeds over such carrying value.		
The Doniphan County Light & Power Company		
Federal Light & Traction Company		
The Ohio Public Service Company		
Spokane Gas & Fuel Company		
The Toledo Edison Company		
(2)		
5% Debentures of Various Maturities Due 1958 to 1969	59,910,200.00	
Proposed 3% Debentures Due January 1, 1977	25,000,000.00	
Earned Surplus	1,983,618.50	
Accrued interest on debentures	10,903,729.44	
Cash in banks and on hand		97,797,547.94
To reflect proposed call of all remaining 5% debentures outstanding at principal amount plus call premium together with accrued unpaid interest ($348,874.58) and unpresented coupons ($10,554,854.86) thereon to October 31, 1946 and the redemption of $25,000,000 principal amount of the proposed 3% debentures at the principal amount thereof. The call premium on the 5% debentures is charged to Earned Surplus.		
(3)		
Provision for Federal taxes on income	165,000.00	
Earned Surplus	2,527,769.57	
Unamortized debenture discount and expense		2,692,769.57
To reflect write off to Earned Surplus balance of unamortized debenture discount and expense (less amount equal to Federal income tax reduction applicable thereto—$165,000.00) relating to the proposed retirement of 5% debentures of various maturities due 1958 to 1969.		
(4)		
Cash in banks and on hand	130,395.63	
Cash in Debenture Purchase Fund		130,395.63
To restore to general cash account the funds on deposit with the trustee since payment in full of entire issue of 5% debentures due 1966 has been provided for in full in entry (2).		

EXHIBIT B-2
Page 1

CITIES SERVICE COMPANY

PRO FORMA INCOME STATEMENT

For the Twelve Months Ended October 31, 1946

Giving effect to the consummation of the plan of simplification of the corporate structure (see Exhibit A-2) and, in addition, adjusted to reflect sale of certain public utility companies and the application of estimated $85,000,000 proceeds to the retirement of the remaining 5% outstanding debentures and $25,000,000 principal amount of the new debentures

(Subject to year-end adjustments)

	Pro Forma Per Exhibit A-2	Pro Forma Adjustments*	Pro Forma
GROSS INCOME:			
Interest on bonds and indebtedness of subsidiary companies	$ 5,142,544.43	$R 40.00(1)	$ 5,142,504.43
Dividends on preferred and common stocks of subsidiary companies	12,598,626.02	R 790,134.63(1)	11,808,491.39
Interest and dividends on other investments	1,840,750.82	.....	1,840,750.82
Interest on notes and accounts receivable; and sundry receipts	4,663.57	.....	4,663.57
TOTAL GROSS INCOME	19,586,584.84	R 790,174.63	18,796,410.21
EXPENSES:			
Administrative and management expenses	1,306,141.92	.....	1,306,141.92
General, legal and other expenses	1,210,592.33	.....	1,210,592.33
Taxes, other than taxes on income	201,766.62	.....	201,766.62
Depreciation of Furniture and Fixtures	60,000.00	.....	60,000.00
TOTAL EXPENSES	2,778,500.87	.....	2,778,500.87
	16,808,083.97	R 790,174.63	16,017,909.34
INTEREST AND OTHER CHARGES:			
Interest on 5% debentures	3,009,441.04	R3,009,441.04(2)	.....
Interest on proposed 3% debentures	3,457,408.50	R 750,000.00(5)	2,707,408.50
Amortization of debenture discount and expense	165,027.64	R 165,027.64(3)	.....
Federal and State taxes on debenture interest coupons	38,421.21	R 38,421.21(4)	.....
Provision for impairment of investment in a subsidiary company	745,000.00	.....	745,000.00
TOTAL INTEREST AND OTHER CHARGES	7,415,298.39	R3,962,889.89	3,452,408.50
	9,392,785.58	3,172,715.26	12,565,500.84
PROVISION FOR FEDERAL INCOME TAX	314,500.00	127,000.00(6)	441,500.00
SPECIAL CHARGE equivalent to estimated reduction of Federal income tax applicable to call premium and other costs on retired securities	54,000.00	.....	54,000.00
	368,500.00	127,000.00	495,500.00
NET INCOME	$ 9,024,285.58	$ 3,045,715.26	$12,070,000.84
Times interest and other charges earned	2.27	.....	4.64

* Figures in parentheses refer to pro forma adjustments.

EXHIBIT B-2
Page 2

CITIES SERVICE COMPANY

INCOME STATEMENT—EXPLANATION OF PRO FORMA ADJUSTMENTS

For the Twelve Months Ended October 31, 1946

To give effect to sale of certain public utility companies and the application of estimated $85,000,000 proceeds to the retirement of the remaining 5% outstanding debentures and $25,000,000 principal amount of the new debentures

(1) Remove dividend and interest income received from Cities Service Power & Light Company and power and light public utility subsidiary companies proposed to be sold	$ 790,174.63
(2) Elimination of interest expense on all remaining 5% debentures of various maturities	3,009,441.04
(3) Elimination of amortization charge on all remaining 5% debentures of various maturities	165,027.64
(4) Elimination of Federal and State taxes assumed on all remaining 5% debentures of various maturities	38,421.21
(5) Reduce annual interest expense in respect of redemption of $25,000,000 principal amount proposed 3% debentures due 1977	750,000.00
(6) Increase in Federal income tax expense in respect of foregoing adjustments	127,000.00

SECURITIES AND EXCHANGE COMMISSION

Philadelphia

IN THE MATTER OF CITIES SERVICE COMPANY File No. 54-153 (Public Utility Holding Company Act of 1935)	FINDINGS AND OPINION OF THE COMMISSION

SIMPLIFICATION OF HOLDING COMPANY SYSTEM

Plan filed by a registered holding company under Section 11(e) of the Act providing for the elimination of preferred and preference stocks and arrears applicable thereto by exchange for new Debentures, and for the reduction in the amount of outstanding debt by the use of treasury cash, *approved*, as necessary to effectuate the provisions of Section 11(b) of the Act and fair and equitable to the persons affected thereby.

APPEARANCES:

CLINTON J. RUCH, EUGENE R. SULLIVAN and JAMES P. FARRELL of FRUEAUFF, BURNS, RUCH & FARRELL and JOSEPH L. WEINER, for Cities Service Company.

ARTHUR RICHENTHAL and IRVING M. Moss with HAROLD F. LEVIN, of DOLSON, LEVIN, GORDON, for a Committee for Preferred Stockholders.

SAMUEL A. MEHLMAN, for individual preferred shareholders.

JOSEPH NEMOROV by LOUIS KIPNIS and ROBERT GORDON for an individual preferred shareholder.

JOSEPH Moss, for individual preferred shareholders.

LOUIS E. CLEVENGER, for the State Corporation Commission of Kansas.

VICTOR I. ZELOV, a holder of preferred stock, *pro se*.

FRANK T. O'BRIEN, a holder of preferred stock, *pro se*.

WILLIAM VAN AARTEEN, for Columbian National Life Insurance Company, a preferred shareholder.

M. MORTON WEINSTEIN and JEROME M. ALPER, of the Public Utilities Division of the Commission.

INTRODUCTION

Cities Service Company (Cities), a registered holding company, has filed an application and an amendment thereto pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935 for approval of a Plan, as amended, (Plan) for the simplification of its corporate structure.

Briefly, the Plan provides for the issuance by Cities of $115,246,950 principal amount of 3% Debentures due 1977, to be issued to the holders of the outstanding preferred and preference stocks which amount is equivalent to the aggregate of the respective redemption prices (including arrearages of dividends) as of December 31, 1946. The Plan also provides for the immediate retirement of $40,578,100 principal amount of Cities' outstanding 5% Debentures due 1950 out of treasury funds. The Plan further provides for the application of the proceeds to be derived from the disposition by Cities of certain hereinafter specified non-retainable utility properties to the retirement of the remaining $59,910,200 principal amount of 5% Debentures. Such proceeds in excess of the amount necessary to complete the retirement of the 5% Debentures will be applied to the reduction of the new 3% Debentures.

After appropriate notice, public hearings were held. Leave to be heard was granted to interested security holders and to a Committee for Preferred Stockholders. As indicated by the record, the Committee and certain of the other participants raised numerous objections to the Plan and suggested modifications thereof. During the course of the proceedings, Cities amended the Plan as originally filed and the objecting participants stated that the amended Plan substantially met their objections and urged its approval.[1] Notice of Filing and opportunity for hearing was given with respect to the Plan, as amended, and no security holder of Cities requested a hearing with respect to the Plan, as amended, or appeared in opposition thereto. Briefs and oral argument were waived.

On the basis of the record, we make the following findings:

DESCRIPTION OF CITIES

Cities, a Delaware corporation, is a holding company whose subsidiaries are engaged principally in the production, transmission and sale of natural gas, oil and oil products and in the electric and gas utility and real estate businesses.[2] Approximately 70% of the consolidated gross revenue of Cities and its subsidiaries for the twelve months ended October 31, 1946 amounting to $322,340,575, was derived from the operations of its oil business. The principal electric utility subsidiaries are The Toledo Edison Company and The Ohio Public Service Company, which supply electric energy in northern Ohio. The principal gas utility companies are The Gas Service Company, which distributes gas in parts of Kansas, Missouri, Oklahoma, and Nebraska,[3] and Arkansas-Louisiana Gas Company, which operates in the States of Arkansas, Louisiana and Texas.

On May 5, 1944 the Commission issued an order pursuant to Section 11(b)(1) requiring Cities to limit its operations to those of a single integrated gas utility system now owned by The Gas Service Company and certain natural gas production and transmission properties of Cities Service Gas Company found retainable therewith, and to dispose of all its other interests.[4] Subsequent to the entry of this

[1] The amended Plan increased the amount of new Debentures to be issued in exchange for the preferred and preference stocks, reduced the term of the new Debentures, added certain protective provisions to the indenture, and eliminated a provision making the effectuation of the Plan conditional upon obtaining consents of stockholders.

[2] Reference is made to Appendix A showing the intercorporate relations of Cities and its subsidiaries, together with businesses in which engaged.

[3] See *The Gas Service Company, et al.* Holding Company Act Release No. 7107 (1946).

[4] *Cities Service Company, et al.*, S. E. C. (1944) Holding Company Act Release No. 5028. Arkansas Natural Gas Corporation, a system holding company, appealed from certain portions of this order directing it to divest itself of certain interests. The order of the Commission was affirmed in *Arkansas Natural Gas Corporation* v. *S. E. C.*, 154 F. (2d) 597, (C. C. A., 5, 1946); *cert. denied* 67 S. Ct. 67 (1946).

rder, Cities made application for an interpretative declaration that the company might comply with he divestment order by retaining its non-utility interests and stated that "it expects to continue its rogram of disposing of its various utility interests and holdings * * * to the point where it shall be ntitled to obtain an exemption" from the provisions of the Act. In our supplemental opinion and rder of October 12, 1944 the exemption question was not resolved and while we stated that Cities' ecision t remain in the non-utility business was appropriate, the decision as to whether and when to pply for an exemption was one for Cities to make.[5] While the record indicates that Cities intends to pply for n exemption order at a later time permitting the company to retain its interests in The Gas Service Company, Republic Light, Heat and Power Company, Inc., and Dominion Natural Gas Company, Limited, the exemption question is not now before us and nothing contained herein is to be deemed a determination of any of the matters which will have to be considered in connection therewith.

Annexed hereto as Appendices B and C are balance sheets of Cities, corporate and consolidated, respectively, as at October 31, 1946, per books, pro forma giving effect to the Plan, and pro forma adjusted to reflect the sale, in partial compliance with the outstanding divestment orders, of The Toledo Edison Company, The Ohio Public Service Company, Spokane Gas & Fuel Company, Federal Light & Traction Company and The Doniphan County Light & Power Company (hereinafter sometimes referred to as the Properties designated for immediate sale) and the application of proceeds therefrom, estimated by the company at $85,000,000 to the retirement of the remaining outstanding 5% Debentures, aggregating $59,910,200 principal amount, and the retirement of $25,000,000 principal amount of 3% Debentures due 1977.[6]

The capitalization and surplus of Cities as at October 31, 1946, on a corporate basis, per books adjusted to include the dividend arrears on the preferred and preference stocks as at December 31, 1946, are shown in Table I:

[5] *Cities Service Company, et al.*, S. E. C. (1944) Holding Company Act Release No. 5350.

[6] A witness for the company characterized the $85,000,000 estimate as a conservative one and indicated that a more optimistic estimate would be $95,000,000. The latter amount is based upon estimated proceeds of $88,000,000 for The Ohio Public Service Company and The Toledo Edison Company and a realization of approximately $10,000,000 in connection with the liquidation of Federal Light & Traction Company. This witness also indicated that the market value of the investment in Spokane Gas and Fuel Company was less than $200,000 and that the plant account of The Doniphan County Light & Power Company amounted to less than $20,000.
The amount of $85,000,000 is used hereinafter for purposes of convenience and appears appropriate for analytical purposes. Deviations either upward or downward would not be important, for example if $75,000,000 or $100,000,000 were obtained the effect on the analysis of the plan would be slight. Further, we do not understand that the disposition by Cities of its interests in the above companies to be contingent upon the realization of the company's estimate of $85,000,000.

[7] W. Alton Jones, President of Cities, testified that, in his opinion, Cities would be able to divest itself of these properties within the very near future.

TABLE I[1]

	Amount	% of Total
Long-term Debt:		
5% Convertible Gold Debentures, due 1950	$ 40,578,100	
5% Gold Debentures, due 1958	25,840,500	
5% Gold Debentures, due 1963	5,125,000	
Refunding 5% Gold Debenture Bonds, due 1966	9,618,700	
5% Gold Debentures, due 1969	19,326,000	
Total Long-Term Debt	100,488,300	32.66
Preferred and Preference Stocks:		
$6 Preferred, no par—560,600 shares	56,060,000	
Unpaid accumulated dividends to December 31, 1946	47,370,700	
	103,430,700	
$6 Preference BB, no par—17,700 shs.	1,770,000	
Unpaid accumulated dividends to December 31, 1946	1,548,750	
	3,318,750	
60¢ Preference B, no par—86,000 shs.	860,000	
Unpaid accumulated dividends to December 31, 1946	752,500	
	1,612,500	
Total Preferred and Preference Stocks	108,361,950	35.21
Common Stock Equity:		
Common Stock $10 par value—3,702,000 shs.	37,020,000	
Capital Surplus	22,580,396	
Earned Surplus (since December 31, 1937)	39,251,146	
Total Common Stock Equity	98,851,542	32.13
Total Capitalization and Surplus	$307,701,792	100.00

[1] There is stated on Cities' books a Reserve for Accrued Undeclared Cumulative Dividends on Preferred and Preference Stocks in an amount of $19,661,150. The foregoing table treats the dividend arrears aggregating $49,671,950 as having been applied to this reserve to the extent of the reserve and the balance of $30,010,800 of the arrears has been deducted from Earned Surplus Account.

The $6 cumulative preferred stock is preferred as to assets and dividends over the $6 cumulative preference BB, the 60¢ cumulative preference B and the common stock, and in liquidation, whether voluntary or involuntary, is entitled to receive $100 per share plus accumulated dividends. The $6 preference BB stock and the 60¢ preference B stock rank *pari passu*, are preferred as to assets and dividends over the common stock and are entitled in liquidation, whether voluntary or involuntary, to $100 and $10 per share, respectively, plus accumulated dividends. The preferred, preference BB and preference B shares may be called for redemption, in whole or in part, at any time, at $112, $106 and $10.60 per share, respectively, plus accumulated dividends. At December 31, 1946, unpaid cumulative dividends on the preferred shares amounted to $84.50 per share, on the preference BB shares to $87.50 per share, and on the preference B shares to $8.75 per share.

THE PLAN

Cities will issue $115,246,950 principal amount of 3% Sinking Fund Debentures due 1977 in exchange for all of the presently outstanding preferred and preference shares and in discharge of all claims to unpaid dividends. The new Debentures will bear interest from January 1, 1947, and dividends on the preferred and preference stocks will cease to accrue from that date. Each share of preferred stock will be entitled to $196.50 principal amount of debentures; each share of preference BB stock will be entitled to $193.50 principal amount of debentures, and each share of preference B stock will be entitled to $19.35 principal amount of debentures. In effecting these exchanges, debentures will be issued in denominations of $100, $500 and $1,000 and Interim Certificates in denominations of $10 or multiples thereof.* Interim Certificates will be in bearer form and when combined with others to aggregate $100 may be exchanged for one debenture. Cities will arrange for the purchase and sale of Interim Certificates without cost to the holders thereof at prices based on market prices prevailing for the new Debentures.

The right of holders of the preferred and preference stocks to receive Debentures, Interim Certificates and cash must be exercised on or before January 1, 1950. After such date Cities will sell the debentures represented by the unexchanged preferred and preference stocks and will hold such proceeds until January 1, 1953, subject to the right of said preferred and preference stockholders to receive their pro rata share of said proceeds. Any unclaimed balance thereof will revert to Cities after January 1, 1953. Similar provisions are made with respect to the exchange of Interim Certificates for Debentures.

The Plan also provides that Cities will call for redemption and retire through the use of treasury cash $40,578,100 principal amount of outstanding 5% Convertible Debentures due 1950 at the redemption price of 102.* The balance of such 5% Debentures aggregating $59,910,200 in principal amount, which are proposed to be retired with proceeds to be derived from the sale of the properties designated for immediate sale, will be senior to the proposed 3% Debentures. As heretofore indicated, Cities is under order to dispose of these properties together with its other utility interests. Proceeds from the divestment of these specifically enumerated properties in excess of amounts required for the completion of the retirement of the 5% Debentures will be applied to the partial retirement of the new debentures.

Cities has requested, in the event the Plan is approved, that the Commission, pursuant to the provisions of Section 11(e) of the Act, apply to an appropriate United States District Court for approval and enforcement of the Plan.

DESCRIPTION OF NEW SECURITIES

The $115,246,950 principal amount of new Debentures will be subordinate in all respects to the outstanding 5% Debentures of Cities. They will be unsecured, dated January 1, 1947, bear interest at the rate of 3% per annum payable semi-annually on January 1 and July 1 of each year, and mature on January 1, 1977. At the option of the company, the new Debentures may be redeemed in whole or in part on any date prior to maturity, upon thirty days' notice, at the principal amount plus accrued interest.

The Indenture under which the new Debentures are to be issued provides, *inter alia*, for (1) an annual sinking fund of $1,500,000, which may be satisfied in cash or by delivery of debentures, (2) the

* Portions of claims aggregating less than $10 will be paid in cash. Thus, a holder of one share of preferred stock will receive a $100 Debenture, a $90 Interim Certificate and $6.50 in cash. The distribution to the preference stockholders can be similarly determined.

* The conversion privilege attaching to these debentures expired in 1935.

application of the net proceeds to be derived by Cities from the sale of its interest in the utility companies heretofore identified to the retirement of the remaining $59,910,200 principal amount of outstanding 5% Debentures, and (3) the application of an amount equal to the excess of such proceeds over the amount required to retire the said 5% Debentures to the partial retirement of the 3% Debentures within three months after the receipt of such funds by delivery to the Trustee of cash or debentures.

In addition, the Indenture contains covenants that:

(a) Cities will not mortgage or pledge any of its portfolio securities (subject to certain exceptions) without either (i) securing the new Debentures equally and ratably with the additional debt secured by such mortgage or pledge or (ii) increasing the sinking fund for the new Debentures in each year during the existence of such additional indebtedness by 2% of the greatest principal amount of such additional indebtedness outstanding during such year;

(b) Cities will not create or assume any funded indebtedness and will not permit any wholly owned subsidiary[10] to create or assume any funded indebtedness or permit any wholly owned subsidiary to issue or sell any of its stock (except where such funded indebtedness and such stock shall be issued to and held by Cities and/or any subsidiary and except for certain specified refunding purposes) unless the consolidated income of Cities and subsidiaries (before provision for taxes on income) for a period of twelve consecutive months within a period of fifteen consecutive months immediately preceding, shall be equal to at least twice the aggregate of the consolidated interest charges, subsidiary companies' preferred dividends and minority interest in income for such period including the charges, requirements and interest on the securities to be issued; and

(c) Cities will not declare or pay any cash dividends on its common stock except out of earned surplus accumulated subsequent to December 31, 1946.

PERTINENT FINANCIAL ASPECTS

Since the Plan provides in essence for the refinancing of Cities' outstanding preferred and preference stocks through the issuance of the new 3% Debentures, the fundamental questions presented by the Plan are (a) whether, in the light of Cities' financial structure, earnings history and prospects, these Debentures may properly be issued in conformity with the applicable standards of the Holding Company Act, and (b) whether the issuance of these Debentures upon the terms proposed to the holders of the preferred and preference stocks results in fair and equitable treatment to them, and to the holders of Cities' common Stock. We shall first turn to a consideration of the financial aspects of the Cities holding company system, and thereafter to the problems of necessity and fairness presented by the Plan.

Balance Sheets

The capitalization and surplus of Cities as at October 31, 1946, on a corporate basis, per books adjusted,[11] pro forma giving effect to the Plan, and pro forma adjusted to reflect the disposition of the

[10] As defined in the indenture, a "wholly owned subsidiary" means any subsidiary in which the Company presently owns or may hereafter acquire, directly or indirectly, stock possessing at least 95% of the voting power of all classes of stock and at least 95% of each class of non-voting stock except non-voting stock which is limited and preferred as to dividends.

[11] The figures per books are adjusted to reflect the preferred and preference stock arrears as indicated in the footnote to Table I, page 6.

properties designated for immediate sale and the application of the estimated proceeds thereof, are shown below in Table II:

TABLE II

	Per Books Adjusted		Pro Forma		Pro Forma Adjusted	
	Amount	%	Amount	%	Amount	%
5% Debentures	$100,488,300	32.7	$ 59,910,200	22.6	$ —	—
3% Debentures	—	—	115,246,950	43.4	90,246,950	39.8
Total Long-Term Debt	$100,488,300	32.7	$175,157,150	66.0	$ 90,246,950	39.8
Preferred Stock	$103,430,700	33.6	$ —	—	$ —	—
Preference Stock	4,931,250	1.6	—	—	—	—
Total Preferred and Preference Stocks	$108,361,950	35.2	$ —	—	$ —	—
Common Equity	$ 98,851,542	32.1	$ 90,216,768	34.0	$136,664,422	60.2
Total	$307,701,792	100.0	$265,373,918	100.0	$226,911,372	100.0

As indicated in the foregoing table, the debt of Cities, which now constitutes 32.7% of the total capitalization and surplus, will, upon consummation of the Plan, be increased to 66%. This increase, however, is a temporary one pending the consummation of the contemplated sales of the utility properties designated for immediate sale and the application of the proceeds thereof in reduction of the debt. Upon this occurrence, the ratio of debt to total capitalization and surplus will be reduced from 66% to approximately 40% and the common stock equity will be increased from about 33% on the per books and pro forma bases to approximately 60%. As shown in Appendix B, neither the common stock account nor the capital surplus account will undergo any change as a result of any of the contemplated transactions. The material improvement in the aggregate common stock equity on the pro forma adjusted basis compared with the book figures (after deducting the $30,010,800 of dividend arrears not otherwise provided for) is accounted for by an increase in earned surplus account. According to the estimates made by Cities, the proceeds to be derived from the contemplated sale of the utility companies designated for immediate sale will be some $50,959,000 in excess of the amounts at which the securities of such companies are carried on the books of Cities. Such excess will be recorded as a profit to Cities, will be credited to earned surplus account and the unrealized appreciation assumed by the company to be inherent in these investments will be reflected in the common equity (surplus). The proceeds will be applied in reduction of Cities' debt. The improved common stock equity results from the fact that the common equity will be larger in absolute terms coupled with the fact that the total capitalization will be smaller.

The capitalization and surplus of Cities as at October 31, 1946, on a consolidated basis, per books adjusted,[19] pro forma giving effect to the Plan and pro forma adjusted to reflect the sale of certain utility companies heretofore identified and the application of the proceeds thereof are shown in Table III.

[19] The figures per books are adjusted to reflect the preferred and preference stock arrears as indicated in the footnote to Table I, page 6.

TABLE III

	Per Books Adjusted		Pro Forma		Pro Forma Adjusted	
	Amount	%	Amount	%	Amount	%
Debt of Subsidiaries	$285,857,867	38.6	$285,857,867	40.9	$204,150,258	38.6
Debt of Cities	100,488,300	13.6	175,157,150	25.1	90,246,950	17.0
Total Debt	$386,346,167	52.2	$461,015,017	66.0	$294,397,208	55.6
Preferred of Subsidiaries	$ 49,099,741	6.6	$ 49,099,741	7.0	$ 13,270,988	2.5
Preferred of Cities	108,361,950	14.7	—	—	—	—
Total Preferred	$157,461,691	21.3	$ 49,099,741	7.0	$ 13,270,988	2.5
Minority Interests	$ 30,133,927	4.1	$ 30,133,927	4.4	$ 25,515,833	4.8
Sub-Total	$573,941,785	77.6	$540,248,685	77.4	$333,184,029	62.9
Cities' Common Equity	$165,896,493	22.4	$157,742,752	22.6	$196,215,314	37.1
	$739,838,278	100.0	$697,991,437	100.0	$529,399,343	100.0

It appears from the above tabulation that upon the consummation of the Plan the ratio of consolidated debt to total consolidated capitalization and surplus would be about 66% compared with approximately 52% per books. However, this ratio will decrease to approximately 56% when Cities sells the utility companies designated for immediate sale and applies the proceeds thereof to the retirement of debt. The ratio of total long-term debt, preferred stock and minority interest to total consolidated capitalization and surplus of 77.6%, per books, will not be materially affected through consummation of the Plan since new 3% Debentures are being substituted for the preferred stocks and the arrearages thereon. When the utility companies which have been designated for immediate disposition have been sold and the estimated proceeds applied to the reduction of Cities' debt, the ratio of all securities senior to the common stock will be reduced from 77.4% to approximately 63% and the common stock equity ratio will rise conversely from approximately 22% to 37.1%. This improvement is due to the fact that upon the sale of these large interests the total consolidated capital structure will have been sharply contracted while the common equity, as heretofore pointed out, will have been increased, principally because of the substantial amount of book profit which Cities expects to record upon the sale of the designated utility companies.

As shown in Appendix B, Cities' investments are carried on its books at cost or less in the aggregate amount of $236,886,8[illegible] as at October 31, 1946.[13] After giving effect to the sale of the utility companies designated for immediate sale (pro forma adjusted), such investments will have been reduced to $202,845,928 of which approximately $168,000,000 will represent investments in companies other than public utilities. Based on $90,246,950 principal amount of 3% Debentures to be outstanding the total asset coverage for the new Debentures on a corporate basis would be 2.51 times.

The consolidated balance sheet of Cities and its subsidiaries as of October 31, 1946, shown in Appendix C, indicates that the consolidated debt, subsidiary companies' preferred stocks and minority interest would have an asset coverage of 1.28 times pro forma and 1.56 times pro forma adjusted.[14] In considering these ratios, it should be remembered that by and large the assets of Cities consist primarily of oil and gas facilities and most of the companies are not required to state their property accounts on

[13] A break-down of these investments brought down to January 13, 1947 is shown in Appendix F attached.

[14] After eliminating a relatively small amount of admitted inflationary items in the plant account.

he basis of original cost. Moreover, the book value of assets is not necessarily a reliable guide as to he real value of the properties or their earning power.

Fixed Capital

The consolidated fixed capital account and the related reserves for depletion and depreciation as t October 31, 1946, per books, pro forma and pro forma adjusted, including adjustments for inflationary tems, ar shown below in Table IV.

TABLE IV

	Per Books	Pro Forma	Pro Forma Adjusted
Fixed Capital (including an undetermined amount of intangibles):			
Petroleum, Natural Gas and Other Fixed Assets	$604,765,782	$604,765,782	$604,765,782
Deduct: Plant Adjustments (Account No. 107)	16,766,336	16,766,336	16,766,336
	$587,999,446	$587,999,446	$587,999,446
Less: Reserve for Depletion, Depreciation and Replacements	249,463,315	249,463,315	249,463,315
Net Petroleum, Natural Gas and Other Fixed Assets	$338,536,131	$338,536,131	$338,536,131
Electric Utility Properties	$166,854,345	$166,854,345	
Deduct: Plant Adjustments (Account No. 107)	3,022,449[1]	3,022,449[1]	
Profit on sale of certain public utility investments held in suspense pending disposition of other like holdings	1,700,027	1,700,027	
	$ 4,722,476	$ 4,722,476	
	$162,131,869	$162,131,869	
Less: Reserve for Depreciation and Replacements	25,746,739	25,746,739	
Net Electric Utility Properties	$136,385,130	$136,385,130	
Gas Utility Properties	$ 67,093,721	$ 67,093,721	$ 67,093,721
Deduct: Plant Adjustments (Account No. 107)	582,976	582,976	582,976
	$ 66,510,745	$ 66,510,745	$ 66,510,745
Less: Reserve for Depreciation and Replacements	21,469,312	21,469,312	21,469,312
Net Gas Utility Properties	$ 45,041,433[2]	$ 45,041,433[2]	$ 45,041,433[2]
Net Fixed Capital (including an undetermined amount of intangibles)	$519,962,694	$519,962,694	$383,577,564
Percent Reserves for Depletion, Depreciation and Replacements to Total Fixed Capital (Including Intangibles and Plant Acquisition Adjustments):			
Including Plant Adjustments	35.37%	35.37%	40.33%
Excluding Plant Adjustments	36.32%	36.32%	41.47%

[1] Represents inflationary items contained in the plant account of The Toledo Edison Company, which company is not subject to original cost determination requirements.

[2] Includes $1,248,091 of plant acquisition adjustments (Account No. 100.5) as determined by the New York Public Service Commission.

Note: Electric Utility Properties includes a small amount of gas properties which the company contemplates selling.

As indicated in the foregoing table the major portion of the property consists of non-utility assets which are not subject to original cost accounting requirements and, consequently, the amount classified in Plant Adjustments, Account 107, is not particularly significant for purposes of analysis.[18]

Depletion and Depreciation

The company produced several expert witnesses who testified as to the depletion and depreciation policies followed by the gas and oil companies in the system. These witnesses, in addition to other company witnesses, testified that the depletion reserves with respect to the system's natural gas business are accrued on either the "exhaustion basis" or "shut-in rock pressure" method and that both methods for arriving at depletion are generally accepted practices. These witnesses testified that such reserves were adequate, in their opinion. With respect to the oil business, the record indicates that the depletion reserves are based upon an amount per barrel of oil produced deemed adequate to amortize the net investment of the company over the estimated lives of such reserves and that the present depletion reserves of the system's oil companies are proper and adequate. Testimony was also offered to the effect that the balance in the reserve for depreciation was reasonable and adequate. As hereinafter discussed, these reserves include accruals for accelerated amortization of war emergency facilities. We turn now to a discussion of the earnings history and prospects of the system.

Earnings (Corporate)

Appendix D attached hereto shows the corporate income of Cities for the calendar years 1938 through 1945, per books, and for the twelve months ended October 31, 1946, per books, and on the pro forma bases previously indicated.

For the purposes of analysis there is shown below in Table V the corporate earnings of Cities for the twelve months ended October 31, 1946 on three bases. Column A shows the earnings per books adjusted to give effect to the elimination for the entire twelve months' period of the interest charges on $35,000,000 principal amount of 5% Debentures which were retired on June 1, 1946. Column B gives effect to the assumptions used in Column A and also reflects the consummation of the Plan, i.e., the issuance of $115,246,950 principal amount of 3% Debentures in exchange for the outstanding preferred and preference stocks and the retirement of $40,578,100 principal amount of outstanding 5% Debentures. The earnings shown in Column C give effect to the assumptions used in Columns A and B and to the sale of the utility properties designated for immediate sale and to the application of the proceeds to the retirement of the remaining outstanding 5% Debentures in the amount of $59,910,200 and to the retirement of $25,000,000 of 3% Debentures.

[18] The record indicates that the property account of Cities Service Gas Company, an indirect subsidiary, contains $16,766,336 allocable to Plant Adjustments, Account 107, which the Federal Power Commission has ordered written off. It appears that the sum of $582,976 applicable to Account 107 is contained in the accounts of Republic Light, Heat and Power Company, Inc., and that the original cost study required of Arkansas Louisiana Gas Company has not yet been completed. These amounts, together with the sum of $3,022,449 of known write-ups in the accounts of The Toledo Edison Company, are shown in Table IV.

TABLE V

	Per Books Adjusted (Col. A)	Pro Forma (Col. B)	Pro Forma Adjusted (Col. C)
Total Income	$19,586,585	$19,586,585	$18,796,410
Expenses:			
Administration, Management, General, Legal, etc.	2,516,734	2,516,734	2,516,734
Depreciation of Furniture and Fixtures	60,000	60,000	60,000
Taxes, other than taxes on income	201,767	201,767	201,767
Provision for Federal Income Tax	363,500	314,500	441,500
	3,142,001	3,093,001	3,220,001
Gross Income	16,444,584	16,493,584	15,576,409
Fixed Charges:			
Interest on 5% Debentures	5,038,346	3,009,441	—
Interest on 3% Debentures	—	3,457,408	2,707,408
Amortization of Debenture Discount and Expense	321,984	165,028	—
Federal and State Taxes on Debenture Interest Coupons	81,145	38,421	—
Special Charge equivalent to estimated reduction of Federal Income Tax applicable to call premium and other costs on retired securities and to property abandonments	54,000	54,000	54,000
Provision for Impairment of Investment in a Subsidiary Company	745,000	745,000	745,000
Total Fixed Charges	6,240,475	7,469,298	3,506,408
Net Income	10,204,109	9,024,286	12,070,001
Dividend Requirements on Preferred and Preference Stocks	3,521,510	—	—
Balance of Net Income	$ 6,682,599	$ 9,024,286	$12,070,001
Times Earned:			
Total Fixed Charges	2.88	2.35	5.46
Total Fixed Charges and Dividend Requirements on Preferred and Preference Stocks	1.75		

The amounts shown in Column A differ from the actual figures on the company's books to the extent that interest charges on the 5% Debentures have been reduced by approximately $1,046,000 representing interest paid on $35,000,000 of 5% Debentures up to the date of retirement on June 1, 1946. The provisions for income taxes and for amortization have been adjusted accordingly.

It will be observed that on a pro forma basis there would have been a net increase in fixed charges which is due principally to the inclusion of the annual interest requirements of $3,457,408 on the $115,246,950 principal amount of 3% Debentures to be issued less approximately $2,000,000 annual

interest requirements on the $40,578,100 principal amount of 5% Debentures to be retired. The net increase in fixed charges of about $1,229,000 is, however, substantially exceeded by the annual preferred and preference stock dividend requirements of $3,521,510 which will be eliminated. The balance of net income applicable to common stock would have been increased approximately $2,341,700.

The effect of the Plan on earnings coverages is indicated by the reduction of the ratio of earnings to total fixed charges from 2.88 per books adjusted to 2.35 pro forma. Since the preferred stocks are to be retired, the ratio of earnings to all charges ahead of the common stock would increase from 1.75 per books adjusted to 2.35 pro forma.

The amounts shown in Column C, pro forma adjusted, give effect not only to the consummation of the Plan but also to the sale of the utility companies heretofore identified, the retirement of the remaining 5% Debentures in the amount of $59,910,200 and the retirement of $25,000,000 of 3% Debentures. It will be noted that on this basis interest requirements would be reduced from $6,466,849 to $2,707,408, the latter amount representing interest on approximately $90,000,000 of new 3% Debentures. Income taxes would be increased in the amount indicated in the table.

In reviewing the corporate earnings of Cities, it should be pointed out that in past years Cities was unable to take up dividends from certain of its important subsidiaries because of dividend arrearages on preferred stocks of such subsidiaries and restrictions on the payment of common dividends by the subsidiaries. Such restrictions for the greater part have been removed, although the full effect of such removal is not reflected in the most recent statements of corporate earnings. Thus, it is more important to examine the consolidated earnings of the system which, independently of the special circumstances here, are usually more significant than the corporate earnings.

Earnings (Consolidated)

The consolidated income of Cities and its subsidiaries for the years 1938 through 1945 per books and for the twelve months ended October 31, 1946, per books, pro forma and pro forma adjusted, is shown in Appendix E.

In appraising the consolidated income consideration should be given to the fact that the Cities system is engaged in the business of producing, processing and selling oil and oil products, producing and transporting natural gas and real estate operations in addition to the public utility business, and consequently, its income and costs of operations have fluctuated widely and may be expected to continue to do so. Moreover, upon disposition of the utility interests, whose earnings have had a stabilizing influence on the consolidated picture, this factor will become more important.

During the years 1942 through 1945 the subsidiaries of Cities were engaged in supplying materials in furtherance of the war effort and to this extent the gross revenues reflect larger sales than might be expected in peace times. Operating costs were also relatively higher during this period. In this connection it is pointed out that in the year 1944 Cities Service Refining Corporation commenced operation of a new refinery which cost approximately $75,000,000. This was a war emergency facility and the company was permitted to amortize the plant at an accelerated rate for income tax purposes. The amount of accelerated amortization is included in the income account for the years 1944, 1945 and 1946 and to some degree has offset the effect of the larger revenues occasioned by war activities.

The amortization or depreciation included in the earnings of Cities Service Refining Corporation amounted to $7,652,091 for the year 1944, $18,930,512 for the year 1945 and $7,375,165 for the twelve months ended October 31, 1946. The record indicates that if such depreciation had been accrued at 5% per annum, which the company has assumed to be a normal rate, the provisions would have amounted

to $2,485,378 for the year 1944, $3,850,000 for the year 1945 and $3,895,451 for the twelve months ended October 31, 1946. It was testified that beginning January 1, 1947, the provision will be approximately $5,700,000 annually until 1949 when the provision will drop to about $3,000,000 annually.

The consolidated provision for depletion, depreciation and replacements for the system as a whole decreased from $52,038,257 in 1945 to approximately $37,800,000 for the year ended October 31, 1946. The latter amount is not substantially more than the provision for the year 1941 after giving consideration to the increased facilities.

There is presented below a condensed summary of the consolidated earnings for the years 1938 through 1945, per books, and for the twelve months ended October 31, 1946, per books adjusted and on the pro forma bases previously described.

TABLE VI

Year	Gross Income before Income Taxes	Gross Income after Income Taxes	Subsidiary Companies' Fixed Charges, Preferred Dividends and Minority Interest	Cities Service Company Fixed Charges and Preferred Dividend Requirements	Total Consolidated Fixed Charges and Preferred Dividend Requirements	Balance of Consolidated Net Income before Income Taxes	Balance of Consolidated Net Income after Income Taxes
1938	$43,086,133	$39,418,259	$23,509,052	$15,427,692	$38,936,744	$ 4,149,389	$ 481,515
1939	42,142,029	38,511,270	22,299,228	14,173,698	36,472,926	5,669,103	2,038,344
1940	45,991,599	39,634,243	20,658,863	12,830,071	33,488,934	12,502,665	6,145,309
1941	57,247,338	44,045,128	21,376,215	11,917,220	33,293,435	23,953,903	10,751,693
1942	64,799,188	45,823,338	20,888,430	11,528,101	32,416,531	32,382,657	13,406,807
1943	60,636,642	44,159,915	17,007,170	11,138,724	28,145,894	32,490,748	16,014,021
1944	53,351,149	41,419,018	16,176,176	10,874,819	27,050,995	26,300,154	14,368,023
1945(A)	44,826,563	39,026,726	14,935,491	12,552,201	27,487,692	19,013,737	11,539,034
12 months ended October 31, 1946:							
Per Books Adjusted	53,426,472	45,424,315	13,963,341	11,571,826	25,535,167	30,514,077	19,889,148
Pro Forma	53,426,472	45,944,472	13,963,341	9,279,139	23,242,480	32,806,764	22,701,992
Pro Forma Adjusted	38,178,232	32,807,017	8,265,312	4,414,462	12,679,774	27,205,512	20,127,243

(A) The decline in gross income for the year 1945 is due primarily to the provision for accelerated amortization of the war facilities of Cities Service Refining Corporation, as heretofore explained.

As indicated in Table VI, annual consolidated gross income before income taxes has varied between $42,000,000 and $65,000,000 during the eight calendar years shown, and amounted to about $53,000,000 for the twelve months ended October 31, 1946. Total consolidated fixed charges and preferred dividend requirements of Cities and its subsidiaries have been consistently decreasing year by year from about $39,000,000 in 1938 to about $25,000,000 for the last twelve-months period, due in part to the retirement of Cities' debt and in part to the reduction of subsidiary charges. While the operations and capital structure of Cities and its subsidiaries have changed considerably over the past nine-year period which included pre-war years, war years and a post-war period, we are satisfied that the historical earnings are a useful guide in determining the appropriateness of the proposed interest charges notwithstanding the wide fluctuations in such earnings. In this connection we note that as shown in Table VI the consolidated gross income consistently has been well in excess of the pro forma consolidated fixed charges of $20,619,708.[16]

Looking at the latest twelve-months period, it appears that consolidated gross income after all taxes, per books adjusted, was 2.08 times total pro forma senior charges which ratio increases to 2.10 times on the basis of pro forma gross income.[17] On the pro forma adjusted basis, reflecting the contemplated sales and partial retirement of debt, senior charges would have been earned 2.83 times.[17]

Without attempting to predict a precise range of reasonably foreseeable earnings,[18] it is clear that the interest requirements of the new 3% Debentures proposed to be issued and other fixed charges of the system will aggregate amounts which are not unreasonable in relationship to the earning capacity and assets of the system.

The effect of the Plan and the contemplated sales and partial retirement of debt upon the consolidated income statement for the twelve months ended October 31, 1946 is shown in the following Table VII.

[16] After eliminating non-recurring charges of $2,622,772 described in Table VII as "Special charges equivalent to estimated reduction of Federal Income Tax applicable to call premium and other costs on retired securities and to property abandonments."

[17] In computing these ratios the item captioned "Special charges equivalent to estimated reduction of Federal Income Tax", etc. (see Table VII) was treated as a reduction from gross income rather than as a fixed charge.

[18] We set forth hereafter the company's projections of 1947 earnings, which indicate coverages on a pro forma and pro forma adjusted bases, and which are substantially comparable with those discussed in the text.

TABLE VII

	Per Books Adjusted (Col. A)	Pro Forma (Col. B)	Pro Forma Adjusted (Col. C)
Gross Operating Revenues	$322,340,575	$322,340,575	$278,736,876
Operating and Other Expenses:			
Operating Expenses	206,417,946	206,417,946	187,301,781
Maintenance and Repairs	17,206,246	17,206,246	14,633,184
Provision for Depletion, Depreciation and Replacements	37,858,798	37,858,798	33,999,882
Taxes, other than taxes on Income	12,408,728	12,408,728	8,989,561
Provision for Taxes on Income	8,002,157	7,482,000	5,371,215
	281,893,875	281,373,718	250,295,623
Net Operating Revenues	40,446,700	40,966,857	28,441,253
Other Income	4,977,615	4,977,615	4,365,764
Gross Income	45,424,315	45,944,472	32,807,017
Fixed Charges:			
Subsidiary Companies:			
Interest and Other Charges	9,195,586	9,195,586	5,950,815
Dividends on Preferred Stock in hands of Public	3,187,205	3,187,205	1,007,611
Minority Interest	1,580,550	1,580,550	1,306,886
Cities Service Company:			
Interest on 5% Debentures	5,024,415	2,995,510	—
Interest on 3% Debentures	—	3,457,408	2,707,408
Amortization of Debenture Discount and Expense	321,984	165,028	—
Federal and State Taxes on Debenture Interest Coupons	81,145	38,421	—
Special Charges equivalent to estimated reduction of Federal Income Tax applicable to call premium and other costs on retired securities and to property abandonments	2,622,772	2,622,772	1,707,054
Total Fixed Charges	22,013,657	23,242,480	12,679,774
Net Income	23,410,658	22,701,992	20,127,243
Dividend Requirements on Preferred and Preference Stocks of Cities Service Company	3,521,510	—	—
Balance of Net Income	$ 19,889,148	$ 22,701,992	$ 20,127,243
Times Earned:			
Total Fixed Charges	2.21	2.10	2.83
Total Fixed Charges and Dividend Requirements on Preferred and Preference Stocks of Cities Service Company	1.87		

On a pro forma basis, fixed charges would have been increased by approximately $1,230,000 which is due principally to an increase in the interest requirements of $3,457,408 on the 3% Debentures less a decrease of approximately $2,029,000 representing a reduction in the interest due to the retirement of approximately $40,000,000 principal amount of 5% Debentures. There would have been a decrease of approximately $520,000 in Federal income taxes because of the increased interest charges. It is pointed out that although fixed charges would have been increased by approximately $1,230,000 the preferred dividend requirements of $3,521,510 would have been eliminated. The balance of net income for common stock on a pro forma basis would have amounted to $22,701,992 compared with $19,889,148 on the basis of the adjusted book figures.

Total fixed charges would have been covered 2.10 times on a pro forma basis compared with a coverage of 2.21 times on the basis of the adjusted book figures. In this connection it is pointed out that the pro forma coverage of 2.10 times is after giving effect to the issuance of 3% Debentures in exchange for the preferred and preference stocks and consequently such coverage may be compared with an over-all coverage for fixed charges and preferred dividend requirements of 1.87 times on the basis of the adjusted book figures.

The amounts shown in Column C of the foregoing Table VII reflect the sale of the utility properties heretofore identified and the application of the estimated proceeds thereof to the retirement of the remaining $59,910,200 principal amount of 5% Debentures and the retirement of $25,000,000 principal amount of 3% Debentures. The gross income on a pro forma adjusted basis would have been approximately $13,100,000 less than the pro forma basis and fixed charges on a pro forma adjusted basis would have been approximately $10,600,000 less than the pro forma basis. As a result the net income on a pro forma adjusted basis would have been approximately $2,600,000 less than the net income on a pro forma basis. However, fixed charges would be earned 2.83 times on the pro forma adjusted basis compared with 2.10 times on a pro forma basis.[19]

As previously indicated, there are presently no important restrictions on the flow of earnings from the subsidiaries to Cities, except in the case of Cities Service Refining Corporation which company is prohibited from paying dividends on its common stock without the permission of the Reconstruction Finance Corporation which holds that company's outstanding mortgage notes.[20]

The most important unit in the Cities system from the standpoint of earnings is the Empire Gas and Fuel Company system. In the twelve months ended October 31, 1946 the two principal subsidiaries of Empire, namely Cities Service Oil Company (Del.) and Cities Service Gas Company, reported net income of $11,576,963 and $5,543,029, respectively. Dividends paid by these companies to Empire aggregated $11,540,125 and dividends paid by Empire to Cities totaled $9,405,000.

Forecasts of earnings, as estimated by Cities, for the year 1947 on corporate and consolidated bases, are shown below in Tables VIII and IX, respectively. In each case Column 1 is on a pro forma basis giving effect to consummation of the Plan and Column 2 is pro forma adjusted to reflect the sale of the utility companies designated for immediate sale.

[19] It should be noted that the fixed charges include special charges equivalent to the estimated reduction of Federal income taxes attributable to the retirement of securities and the abandonments of property in the amount of $2,622,772 on a per books adjusted basis and on a pro forma basis and in the amount of $1,707,054 on the basis of the adjusted pro forma figures. It appears that if the companies did not have the benefit of these deductions for income tax purposes, the provision for taxes on income would have been correspondingly higher and consequently net income has not been affected. In computing the above-mentioned earnings coverage ratio this item was assumed to be a deduction from gross income rather than a fixed charge.

[20] Cities Service Refining Corporation reported net income of $1,076,617 for the twelve months ended October 31, 1946 after providing for accelerated amortization. Earned surplus account showed a deficit of $18,103,840 at October 31, 1946. Contributed surplus amounted to $13,236,000 at October 31, 1946 and represents contributions by other system companies in amounts equal to reductions in Federal income and excess profits taxes occasioned by the inclusion of the accelerated amortization program of Cities Service Refining Corporation in the consolidated tax return.

TABLE VIII

Forecast of Earnings as Estimated by Cities for the Year 1947 on a Corporate Basis

	Pro Forma (Col. 1)	Pro Forma Adjusted (Col. 2)
Total Income	$21,627,000	$15,788,000
Expenses and Taxes	2,947,000	2,890,000
Gross Income	18,680,000	12,898,000
Fixed Charges:		
Interest on Debentures	6,453,000	2,706,000
Other	273,000	—
Total Fixed Charges	6,726,000	2,706,000
Net Income	$11,954,000	$10,192,000
Times Fixed Charges Earned	2.78	4.76

TABLE IX

Forecast of Earnings as Estimated by Cities for the Year 1947 on a Consolidated Basis

	Pro Forma (Col. 1)	Pro Forma Adjusted (Col. 2)
Gross Operating Revenues and Other Income	$332,581,000	$284,685,000
Operating Expenses, Other Costs and Taxes	282,682,000	248,664,000
Gross Income	49,899,000	36,021,000
Fixed Charges:		
Subsidiary Companies	13,710,000	8,859,000
Cities Service Company		
Interest on Debentures	6,453,000	2,706,000
Other	160,000	—
Total Cities Service Company	6,613,000	2,706,000
Total Fixed Charges	20,323,000	11,565,000
Net Income	$ 29,576,000	$ 24,456,000
Times Fixed Charges Earned	2.46	3.11

In connection with the future operations of the system, the company produced several expert witnesses who testified with respect to the system's oil and gas reserves. This testimony indicates that the net developed and producing and net proved undeveloped crude oil reserves of the principal oil companies in the system estimated at approximately 306,000,000 barrels at October 31, 1946 would be

recovered over a period of 40 years at a declining rate, and that almost 90% of such reserves would be produced within approximately 21 years. The foregoing estimates are exclusive of any oil which may be found on the 2,200,000 acres under lease. In this connection, the importance of new discoveries is shown by the record which indicates that net crude oil reserves of the system prior to 1928 were less than 50,000,000 barrels and that between 1928 and 1937 reserves increased to 300,000,000 barrels. With respect to the estimated life of the important natural gas reserves, it was testified that they would be economically sufficient for the requirements of the system's principal pipelines for approximately 25 years, and that smaller amounts of gas would be available for an additional period. The record is clear, however, that the company has in the past and is expected, in the future, to actively seek new sources of supply and develop additional oil and gas fields.[21]

After considering all of the financial data in the record including the historical earnings of the system, the amount of oil and gas reserves estimated to be available and the estimated future earnings and prospects, we conclude that the system has adequate assets and earning power to justify the security structure proposed in the Plan. Underlying this conclusion is the weight we have given to the representation made as an integral part of the Plan that the company will dispose of the properties designated for immediate sale and apply the proceeds thereof in reduction of outstanding debt.

Having thus found that the proposed security structure is not inconsistent with the applicable standards of the Act, we now turn to a consideration of the problems of necessity and fairness raised by Section 11(e) of the Act.

APPLICABLE STATUTORY STANDARDS

Before we can approve a Plan under Section 11(e) of the Act, we must find that the Plan is necessary to effectuate the provisions of Section 11(b) and fair and equitable to the persons affected thereby. In addition, we must find that the various transactions proposed in connection with the Plan satisfy the requirements of the other applicable provisions of the Act.

The "Necessity" Standard

As has been heretofore pointed out, the capital structure of Cities consists of funded debt, represented by 5% Debentures in five series each with a different maturity extending from 1950 to 1969, three preferred stocks, two of which are junior preference stocks, and common stock. Such a stratification of securities at the apex of Cities' pyramided holding company system by itself constitutes an undue complexity, particularly in terms of the difficulties confronting the investor in undertaking to appraise his position. In this connection we have also noted that many of Cities' subsidiaries have outstanding large amounts of senior securities whose fixed charges and dividend requirements represent prior charges to and absorb large proportions of the earnings of the system. We have also seen that huge amounts of dividend arrearages have accumulated on the preferred and preference stocks of Cities whose holders, with the exception of a partial dividend payment to the preferred stockholders in 1941, have been without any income whatsoever since 1932, the last year also in which Cities' common stockholders received any dividends. In the light of these facts and of the subsidiary findings we have made above with respect to the assets and earnings of Cities in relation to its capital structure, it is clear that the corporate structure of Cities unduly and unnecessarily complicates the structure of the Cities holding company system; and we so find.

[21] Recoverable natural gas reserves, including those gas fields dedicated to the system gas companies under gas purchase contracts, were estimated at approximately 10 trillion cubic feet. There is included in this amount natural gas reserves of Cities Service Oil Company (Delaware) estimated at 2 trillion cubic feet. Testimony of witnesses indicated that if that company successfully used any of the prospective processes now being studied or developed for making liquid hydrocarbons from natural gas, the company would thereby have an additional gasoline supply, but at the cost of diminution of its natural gas reserves.

We consider next whether the Plan will accomplish the simplification of the Cities' structure as required by the Act. In this connection, it may be noted initially that in order to meet the "necessity" standard of Section 11(e), a plan need not be the only plan which would accomplish the required result. It is sufficient if the Plan provides a suitable means of accomplishing the statutory results since the compulsion of Section 11 is one of result and not of method.[22] The Plan contemplates that Cities' capital structure will contain only one class of debt although, as we have seen, two classes will be outstanding initially pending consummation of the sales heretofore referred to and the application of the proceeds to debt retirement. There will be no stock other than common stock in the new structure of Cities. The substantial reduction in amounts as well as classes of outstanding debt, and the complete elimination of the preferred and preference stocks with their applicable dividend arrearages constitute a very substantial measure of simplification of Cities' capital structure.[23] At the same time, the flow of income to the preferred and preference stockholders through the payment of interest on the new Debentures will be resumed immediately and earnings will, for the first time in many years, become available for distribution to the common stockholders. It is thus apparent that the Plan will produce a substantial simplification of Cities' structure including practical results which are extremely desirable from the point of view of Cities' stockholders. We have already found that the proposed new security structure is reasonably related to the underlying assets and earning power and otherwise meets the standards of the applicable provisions of the Act. Accordingly, we find that the Plan is necessary to effectuate the provisions of Section 11(b), subject, of course, to it being found fair and equitable and in conformity with the remaining provisions of the Act which are applicable.

The "Fair and Equitable" Standard

The persons who are affected by the Plan and to whom its provisions must be found fair and equitable are the preferred, preference and common stockholders of Cities.[24] We first consider the fairness problem from the point of view of the preferred and preference stockholders.

It is well established that in measuring the claims which preferred stockholders surrender in a Section 11(e) plan such as this, their rights in liquidation are not considered to have matured by operation of Section 11; and consideration must be given to all of the rights and limitations attaching to the preferred stocks, with primary emphasis upon immediately operative rights such as rights in respect of earnings and dividends as against inchoate rights such as rights in liquidation.[25] It is also well established that fairness requires that affected security holders receive, under the Plan, the equitable equivalent of what they surrender,[26] there being no requirement that dollar values be placed on what is surrendered and received, since to do so would create "an illusion of certainty where none exists."[27]

We consider then whether equitable equivalence is afforded by the present Plan. Such consideration requires a comparison of the financial attributes of the present position in the enterprise of the preferred and preference stockholders with the position afforded them by the Plan as holders of the new 3% Debentures.

[22] *In re North Continent Utilities Corporation*, 54 F. Supp. 527, 530 (D. Del., 1944).

[23] In this connection, it is to be noted that the sinking fund provision in the indenture will operate to retire approximately 50% of the $90,000,000 principal amount of 3% Debentures contemplated to be outstanding.

[24] The holders of the presently outstanding 5% Debentures are not materially affected by the Plan since they will remain undisturbed until called.

[25] *The United Light and Power Company*, 13 S. E. C. 1 (1943), enforced in 51 F. Supp. 217 (Dist. Del. 1944), aff'd *sub nom. Otis & Co.* v. *S. E. C.*, 142 F. 411 (C. C. A. 3, 1944), aff'd 323 U. S. 624 (1945); *New England Gas and Electric Association*, Holding Company Act Release No. 6729 (1946), and case there cited at page 13, enforced in U. S. Dist. Ct. for the Dist. of Massachusetts (unreported 1946).

[26] *Group of Institutional Investors* v. *Chicago, St. Paul & Pacific R. Co.*, 318 U. S. 523; *In re Standard Gas & Electric Co.*, 151 F. (2d) 326, *cert. denied*, U. S. 66 S. Ct. 820.

[27] *Group of Institutional Investors* v. *Chicago, St. Paul & Pacific R. Co., supra.*

As previously indicated, the rights of the preferred and preference stockholders *vis-a-vis* the common stockholders include a prior but limited claim to dividends and to dividend arrearages, a preference as to assets in liquidation prior to the common stockholders but junior to creditors, and the right upon voluntary redemption to receive their respective call prices.[28]

The record establishes that the preferential rights of the preferred and preference stockholders have been of little practical moment to them. Except for the $3 payment received by the preferred stockholders in 1941, they and the preference stockholders, like the common stockholders, have been without any dividends since 1932. During several of the years which have elapsed the management has devoted available cash to the reacquisition by open market purchases of huge amounts of Cities' outstanding debentures and preferred stocks. In more recent years, while dividend requirements have been more than earned,[29] dividend payments have been withheld and the cash accumulated. The management's stated purpose in thus conserving cash has been to meet forthcoming debt maturities and such needs as might arise in the operations of Cities' subsidiaries. As to the immediate future, absent the plan, the president of Cities testified that he would not recommend the payment of preferred dividends.

From the point of view of dividend income, it is thus apparent that the position of the preferred and preference stockholders, at the present time and historically, is not an enviable one. Of course a factor which has loomed large is the huge amount of debt securities which have been senior to the preferred and preference stocks, absorbing very substantial portions of such funds as have become available to Cities, not only for annual interest requirements but for sinking fund purposes as well.

The foregoing factors as to the dividend record of the preferred and preference stocks, their attenuated position in the system's corporate structure and the large amounts of debt to which they are junior have been reflected in the substantial discounts at which the securities have been traded in the market.[30]

On the other hand, the contention has been made that since available earnings have exceeded the annual preferred and preference stock dividend requirements in recent years by a substantial margin,[31] consideration should be given to whether there should be included in the rights and claims of the preferred and preference stockholders a claim to compensation for the withholding of dividend payments. As already noted, in several of the years subsequent to 1932, when the company's earnings and cash position appeared to warrant the payment of dividends in some amounts, the management devoted cash to the purchase in the open market at substantial discounts of large amounts of its outstanding debentures and 6% preferred stocks.[32] It is thus suggested that effecting such purchases in the face of the large accumulations of preferred stock dividend arrearages was inconsistent with the appropriate exercise of managerial discretion; that in effect the common stockholders, through the very substantial scaling down of senior securities, have derived extensive benefits at the expense of preferred and preference stockholders; and that fairness and equity now require that the latter be compensated on this account upon surrendering their rights and claims under the Plan. In this respect the management

[28] These call prices as well as other significant charter rights of the preferred and preference stockholders have been summarized at page 6, *supra*.

[29] Except in the year 1942, the annual dividend requirements on Cities' preferred and preference stocks have been earned by a substantial margin in each year from 1940 through 1945, and for the 12 months ended October 31, 1946; see Appendix D.

[30] Of course, market prices by themselves render neither valid nor invalid the treatment proposed under a plan. See *Lahti* v. *New England Power Association*, F. (2d) (C. C. A. 1, April 11, 1947).

[31] See Appendix D indicating that corporate net income in the years 1944 and 1945 and for the 12 months ended October 31, 1946, has averaged approximately $7,500,000 while the annual preferred and preference stock dividend requirements have amounted to about $3,500,000.

[32] The company became a registered holding company in 1941. During the period from 1933 through 1940 the record indicates that Cities expended $14,989,279 in reacquiring $19,965,700 principal amount of 5% Debentures and expended $29,712,065 in reacquiring $61,675,839 minimum liquidating value of preferred and preference stocks exclusive of arrearages.

asserts, among other things, that since the policy pursued by it resulted in the retirement at substantial discounts of large amounts of debentures and preferred stocks, including accumulated arrearages, its action was in the best interests of the preferred and preference stockholders, as well as the common, and further that the earnings, cash position of the company, and the nature and needs of the company made it an appropriate exercise of management discretion, in any event, to withhold payment of dividends.

We are not required to measure with precision any of the separate factors underlying an overall appraisal of what constitutes fair and equitable treatment. We have, however, in determining whether the Plan affords equitable equivalence, given consideration to the circumstances summarized above.

By operation of the Plan the preferred and preference stockholders of Cities will become its creditors in principal amounts equivalent to the respective redemption prices of their present holdings of preferred and preference stocks. Of course, in exchange for such creditor status, the preferred and preference stockholders will surrender, among other things, their existing claims to the payment in full of accumulated dividend arrearages before any income may be distributed to the common stockholders. However, as creditors they will be the senior security holders of Cities[33] and will enjoy an enforceable right to a fixed claim to Cities' earnings. Such claim will be junior only to the prior claims upon system earnings represented by the outstanding securities of the subsidiaries. From the point of view of annual income, the principal amount of debentures to be received will produce interest to the holders of the preferred stock, Preference B and Preference BB stocks, in the amounts of $5.895, $5.805 and $.58, respectively, as compared with their present annual dividend rates of $6, $6 and $.60. While the income to be received is slightly less, its quality from an investment point of view will be substantially superior. In this connection there is to be noted not only the enforceable aspect of the new earnings claim but the financial aspects of the new Debentures set forth earlier in our consideration of the attributes of the new Debentures in the light of the applicable standards of the Act.[34] It is our judgment that the slight reduction of income, the capitalization of arrearages and the surrender of the claim with respect to the withholding of dividends are compensated for by the substantial improvement in the quality of claim represented by the new 3% Debentures and the principal amount of the Debentures proposed to be distributed.

Cities' financial structure as heretofore discussed makes it extremely unlikely that Cities could presently undertake to redeem or refinance its preferred stocks. However, it is to be noted that under the exchange provisions of the Plan the preferred and preference stockholders will have preserved to them the precise call prices attaching to their present holdings since upon any call of the new Deben-

[33] Temporarily, of course, the claim will be junior to the approximately $60,000,000 principal amount of 5% Debentures to be outstanding immediately upon the consummation of the Plan but to be retired subsequently with the proceeds from the sale of the assets previously referred to.

[34] Expert testimony was offered to the effect that immediately upon their issuance, the new Debentures would sell at approximately 90% of their principal amount, and, assuming continuation of current interest rates, that upon complete retirement of the 5% Debentures, the new Debentures would sell at or about par. It should be noted that this testimony was given in connection with the provisions of the Plan as originally filed, and that the various amendments made to the Plan, such as the earnings coverage limitation on the issuance of system securities, the reduction in the maturity of the new Debentures, and the surplus freeze would appear to improve the quality of the new Debentures. However, in a determination of the issue of equitable equivalence, we have heretofore held that it is not essential to fairness that the market worth be the same as the face amount of the claim of the affected security, and we make this finding to that effect in this case. See *Lahti* v. *New England Power Association*, F. (2d) (C. C. A. 1, April 11, 1947), where the Court said:

> "Of course, the validity of the proposed allocations ought not to depend upon the day to day fluctuations of the market estimates as to what price [the new securities] would command if and when issued. The Commission made no estimate of this sort, and it did not need to."

Also see *Community Gas & Power Co.* and *American Gas and Power Co.*, S. E. C. (1947), Holding Company Act Release No. 7131, plan enforced D. Del. (April 1947 unreported).

tures, which are callable at their principal amount, the holders will receive the same amount of cash as they would have received in connection with any call of the preferred and preference shares.[35]

In the light of the foregoing, we are satisfied that when due consideration is given to the substantial improvement in the status of Cities' present preferred and preference stockholders through the mutation of their claims to a creditor position, the exchanges proposed by the Plan provide the equitable equivalent of the rights surrendered. Accordingly, we are satisfied that the Plan, insofar as it relates to the preferred and preference stockholders, is fair and equitable.[36] We turn now to a consideration of the Plan as it affects the common stockholders.

The existing dividend arrearages on the preferred and preference stocks constitute a barrier to the payment of dividends on the common stock. As a result of the Plan, the claim to arrearages will be removed, thereby enabling the common stock to participate in the earnings of the enterprise. It should also be pointed out that the annual preferred and preference dividend requirements presently aggregating $3,521,510 compare favorably in dollar amount with the annual interest requirements of $3,457,408 on $115,246,950 principal amount of new 3% Debentures. A similar comparison obtains in respect of the annual interest charges and preferred dividend requirements of approximately $8,521,000 based upon the amount of 5% Debentures and preferred and preference stocks presently outstanding and the annual interest charges on the new Debentures and the remaining 5% Debentures in the amount of approximately $6,457,000.

As indicated in Table VII the consolidated net income after preferred dividend requirements of Cities Service Company for the twelve months ended October 31, 1946 amounted to $19,889,148 on a per books adjusted basis. The comparable figure on a pro forma basis is $22,701,992 and on a pro forma adjusted basis is $20,127,243. In this connection it is pointed out that no part of the $19,889,148 is presently available to the common stockholders because of the dividend arrearages on the preferred stocks, whereas all of the net income on the pro forma and pro forma adjusted bases would be applicable to the common stock. While the consolidated pro forma adjusted net income would have been approximately $2,000,000[37] less than the pro forma net income, it would have represented approximately 61% of gross income as compared with 49% on the pro forma basis and 44% on a per books adjusted basis. It thus becomes evident that the quality of the net income applicable to the common stock would have been materially improved. Thus, in simplifying the corporate structure of Cities, in reducing senior claims to income, in eliminating preferred stock arrearages so that future income may be available for

[35] This result does not mean that we consider that the claims of the preferred and preference stockholders are being retired at their respective call prices, nor that they are entitled as a matter of law to the call price as such. It is well established that a retirement of senior securities pursuant to the impact of Section 11 is not a voluntary retirement so as to bring into play the redemption provisions of the charter or indenture. See *American Power & Light Company*, S. E. C. (1945), Holding Company Act Release No. 6176, involving the retirement of debentures, and *Lahti* v. *New England Power Association*, page 42, *supra*, involving the retirement of preferred stocks. See also *New York Trust Co.* v. *S. E. C.*, 131 F. (2d) 274 (C. C. A. 2, 1942), *cert. den.* 318 U. S. 739, rehearing denied 319 U. S. 781; *City National Bank & Trust Co.* v. *S. E. C.*, 134 F. (2d) 65 (C. C. A. 7, 1943); *In re Laclede Gas Light Co.*, 57 F. Supp. 997 (E. D. Mo. 1944), aff'd *sub. nom. Massachusetts Mutual Life Insurance Co.* v. *S. E. C.*, 151 F. (2d) 424 (C. C. A. 8, 1945), *cert. den.* 327 U. S. 796 (1946).

[36] We have hereinbefore described the mechanics of the exchange provisions under the Plan. These provisions, including the time limitations within which the various exchanges can be effected, are reasonable and similar to those which we have approved in other Section 11(e) proceedings.
As before noted, the new Debentures are to bear interest from January 1, 1947 whereas dividends on the preferred and preference stocks are to cease to accrue after December 31, 1946. Since the annual interest on the principal amount of debentures to be exchanged for the outstanding preferred and preference stocks so closely approximates the annual dividend requirements on such stocks, the time lag necessarily involved in effectuating the Plan would not materially affect the fairness of the Plan.

[37] The decrease in net income is occasioned by the fact that the loss of income due to the sale of the utility properties is greater than the amount of savings which can be effected through the application of the proceeds of such sales to the retirement of outstanding debt.

the common stock, and in improving the quality of the net income applicable to the common stock, the common stock is benefited by the provisions of the Plan.[28]

We have considered all of the relevant facts and data in the record, the more significant aspects of which have been summarized in the foregoing analytical discussion. We have reached the conclusion that the Plan affords the preferred, preference and common stockholders of Cities the equitable equivalent of the rights and claims which they are to surrender.

OTHER APPLICABLE SECTIONS OF THE ACT

The new Debentures and Interim Certificates come before us for approval under Section 7 of the Act. Since the securities to be issued by Cities are for the purpose of effecting a reorganization, we find that they meet the requirements of Section 7(c)(2)(A) of the Act. Further, we observe no basis for making adverse findings pursuant to Section 7(d). We find that the proposed acquisition and retirement by Cities of its preferred and preference stocks complies with Section 12(c) and Rule U-42 thereunder. The proposed redemption by Cities of $40,578,100 of 5% Debentures is exempt from the requirements of Section 12(c) by virtue of the provisions of Rule U-42(b)(2).[29]

OTHER MATTERS CONSIDERED

Fees and Expenses

The Plan provides that Cities will pay such fees and expenses for services rendered in connection with the Plan as may be allowed by the Commission. The record is not complete with respect to these items and, accordingly, we shall reserve jurisdiction with respect thereto.

Request for Recitals for Tax Purposes

Cities has requested that our order herein conform to and contain the recitals specified in Section 1808(f) and Supplement R of the Internal Revenue Code, as amended. Our order will so provide.

Request for Court Enforcement

We have been requested, pursuant to Section 11(e) of the Act, to apply to an appropriate District Court of the United States to enforce and carry out the terms and provisions of the Plan. Such request will be granted and application will be made to an appropriate court for an enforcement order.

CONCLUSION

On the basis of the foregoing, we find that the Plan is fair and equitable to the persons affected by it, and is necessary to effectuate the provisions of Section 11(b) of the Act, and that the transactions to be undertaken in connection with it meet the standards of the other applicable sections of the Act. We shall issue an order approving the Plan and apply to the proper United States District Court for its enforcement in accordance with request of the applicant.

As we have noted above, jurisdiction will be reserved with respect to fees and expenses, and such other matters as may appear appropriate in connection with the Plan, the transactions incident thereto, and the consummation thereof.

By the Commission, (Chairman Caffrey and Commissioners McConnaughey, Hanrahan, McEntire and McDonald.)

[SEAL]

ORVAL L. DUBOIS
Secretary

[28] In considering the fairness of the Plan to the common stockholders, it should be noted that, though the Plan makes no distinction in the treatment of the preferred and preference stocks, it is clear that the preference stocks, which are junior to the preferred stocks, are not as favorably situated as the preferred, and, therefore, may not be entitled to treatment on a parity. However, the amounts of any differentials involved are so small in relation to the residual equity applicable to the common stock as to present no material problem of fairness to the common stock.

[29] We have considered this proposed payment of the redemption price in the light of all of the circumstances of this case, and are not constrained to take action under Rule U-100 so as to require that the redemption be subjected to our approval.

Appendix A

Principal Companies in the Cities Service System as of January 31, 1947

	Type of Business
Cities Service Company:	Holding Company
Arkansas Natural Gas Corporation	Holding Company
Arkansas Fuel Oil Company	Oil Prod., Transp., Ref. and Mktg.
Arkansas Pipeline Corporation	Common Carrier Oil Pipeline
Orange State Oil Company	Oil Marketing
Arkansas Louisiana Gas Company	Nat. Gas Prod., Trans. and Dist.
Brightman Manufacturing Company, The	Manufacturing
Chesebrough Building Company	Real Estate
No. 8 State Street Realty Corporation	Real Estate
Cities Service Defense Corporation	Manu. of Munitions
Cities Service Oil Company of Argentina, S.A.C. e I.	Oil Marketing
Cities Service Oil Company (France)	Owns Refinery Site
Cities Service Oil Company (Pennsylvania)	Oil Prod., Transp., Ref. and Mktg.
Crew Levick Corporation	Owns Oil Marketing Property
Forward Process Company	Owns Patents
Kallaher and Mee, Inc.	Marketing of Petroleum Products
Metered Oil, Inc.	Petroleum Prod. and Transp.
Patoil Corporation	Owns Aircraft
Swiflite Aircraft Corporation	Oil Refinery
Cities Service Refining Corporation	Oil Marketing (inactive)
Combustible, S.A.	Oil Leaseholding (inactive)
Compania de Terrenos Petroliferos "Imperio", S.A.	Transit
Community Traction Company, The	Transit
Maumee Valley Transporation Company, The	Nat. Gas Prod., Trans. and Dist.
Dominion Natural Gas Company, Limited	Electric Utility
Doniphan County Light & Power Company, The	Service Company
Electric Advisers, Inc.	Holding Company
Empire Gas and Fuel Company	Inactive
American Gas Production Company	Nat. Gas Prod., Trans. and Sale
Cities Service Gas Company	Oil Prod., Transp., Ref. and Mktg.
Cities Service Oil Company (Delaware)	Common Carrier Oil Pipeline
Cities Production Corporation	Oil Marketing
Empire Pipeline Company	Holding Company
Cities Service Oil Company, Limited	Realty (inactive)
Federal Light & Traction Company	Realty
Electric Land Company, The	Electric, Gas, Water and Ice
Federal Realty Company	Owns Rural Electric Lines leased to Associate Companies
Public Service Company of New Mexico	Service Company
Stonewall Electric Company	Gas Utility
Gas Advisers, Inc.	Owns Oil Leaseholds and Royalties
Gas Service Company, The	Owns Oil Leaseholds
Mexico-Eastern Oil Company	Electric Utility and Transit
Mexico-Texas Petrolene and Asphalt Company	Gas Prod. and Trans.
Ohio Public Service Company, The	Service Company
Penn-York Natural Gas Corporation	Gas Utility
Petroleum Advisers, Inc.	Owns Oil Leaseholds
Republic Light, Heat & Power Company, Inc.	Owns Real Estate
Sabino Gordo Petroleum Corporation	Owns Real Estate
Sixty Wall Street	Gas Utility
Sixty Wall Tower, Inc.	Elec. and Gas Utility and Steam Heating
Spokane Gas & Fuel Company	Realty
Toledo Edison Company, The	Oil Leaseholds
Toledo & Indiana Realty Company, The	
Zulia Petroleum Corporation	

CITIES SERV

CORPORATE BALANCE SHEETS

Assets

	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
Investments and Advances:			
Subsidiary Companies, other than public utilities:			
Securities—at cost or less	$167,997,476	$167,997,476	$167,997,476
Public Utilities, including Arkansas Natural Gas Corp.:			
Securities—at cost or less	61,051,187	61,051,187	27,024,229
Advances	7,477,867	7,477,867	7,477,867
Other Investments and Advances—at cost, less reserve	360,356	360,356	346,356
Total Investments and Advances	$236,886,886	$236,886,886	$202,845,928
Office Furniture and Fixtures—at cost, less reserve	26,851	26,851	26,851
Cash in Debenture Purchase Fund	130,396	130,396	—
Current Assets:			
Cash and U. S. Government Securities	88,780,821	44,810,086	32,142,934
Other	171,164	171,164	171,164
Total Current Assets	88,951,985	44,981,250	32,314,098
Other Assets	20,610	20,610	20,610
Deferred Charges:			
Unamortized Debenture Discount and Expense	3,198,482	2,692,770	
Other	8,332	8,332	8,332
Total Deferred Charges	3,206,814	2,701,102	8,332
	$329,223,542	$284,747,095	$235,215,819

Appendix B

OMPANY

OCTOBER 31, 1946

Liabilities and Capital	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
Long Term Debt:			
5% Convertible Gold Debentures due 1950	$ 40,578,100	$	$
5% Gold Debentures due 1958	25,840,500	25,840,500	
5% Gold Debentures due 1963	5,125,000	5,125,000	
Refunding 5% Gold Debenture Bonds due 1966	9,618,700	9,618,700	
5% Gold Debentures due 1969	19,326,000	19,326,000	
3% Debentures due January 1, 1977		115,246,950	90,246,950
Total Long Term Debt	100,488,300	175,157,150	90,246,950
Capital Stock:			
Preferred and Preference Stocks:			
$6 Cumulative Preferred, N. P. V.—560,600 shares	56,060,000		
$6 Cumulative Preference BB, N. P. V.—17,700 shares	1,770,000		
60¢ Cumulative Preference B, N. P. V.—86,000 shares	860,000	—	—
Total Preferred and Preference Stocks	58,690,000		
Common Stock Equity:			
Common Stock, $10 P. V.—3,702,000 shs.	37,020,000	37,020,000	37,020,000
Capital Surplus	22,580,396	22,580,396	22,580,396
Earned Surplus (since December 31, 1937)	69,261,946	30,616,372	77,064,026
Total common stock equity	128,862,342	90,216,768	136,664,422
Total Capital Stock	187,552,342	90,216,768	136,664,422
Current Liabilities:			
Accrued Interest on Debentures and Unpresented Coupons	13,034,802	10,903,729	
Other	1,795,043	1,777,543	1,612,542
Total Current Liabilities	14,829,845	12,681,272	1,612,542
Reserves:			
Accrued Undeclared Cumulative Dividends on Preferred and Preference Stocks to December 31, 1937	19,661,150		
Adjustment of Investments	6,600,000	6,600,000	6,600,000
Federal Income Tax, prior years	91,905	91,905	91,905
Total Reserves	26,353,055	6,691,905	6,691,905
	$329,223,542	$284,747,095	$235,215,819

NOTES:

(1) Giving effect to the Plan.

(2) To reflect the sale of The Toledo Edison Company, The Ohio Public Service Company, Spokane Gas & Fuel Company, Federal Light & Traction Company and The Doniphan County Light & Power Company and the application of estimated proceeds therefrom of $85,000,000 to the retirement of the remaining outstanding 5% Debentures, aggregating $59,910,200 principal amount, and the retirement of $25,000,000 principal amount of 3% Debentures due 1977.

Cities has guaranteed the repayment of $9,647,589 of the loans made by the Reconstruction Finance Corporation to the Cities Service Refining Corporation and undertaken to advance such subsidiary such amounts as may be required by the latter under its guaranty of bank credit of $1,000,000 extended to a building contractor.

CITIES SERVICE COMPANY

CONSOLIDATED BALANCE SHEET

Assets

	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
Fixed Capital:			
Properties (including undetermined amount of Intangibles) and expenditures on undeveloped properties and projects	$ 838,713,849	$ 838,713,849	$671,859,503
Excess of investment carrying value over equity in Subsidiary Companies at dates of acquisition	114,328	114,328	(4,050,286)
	838,828,177	838,828,177	667,809,217
Deduct: Profit on sale of certain public utility investments held in suspense pending disposition of other like holdings	1,700,027	1,700,027	
Total Fixed Capital	837,128,150	837,128,150	667,809,217
Investments and Advances, at cost or less	31,151,588	31,151,588	30,943,923
Special Funds:			
Deposit under Purchase Contract	149,619	149,619	149,619
Sinking Fund Assets—Cash	315,654	315,654	
Construction and Other Special Funds	2,758,229	2,758,229	3,522
Total Special Funds	3,223,502	3,223,502	153,141
Current Assets:			
Cash in Bank and on Hand	160,295,970	116,325,236	83,414,227
U. S. and Canadian Government Securities (Cost)	6,173,688	6,173,688	5,510,688
Other	80,392,389	80,392,389	73,165,870
Total Current Assets	246,862,047	202,891,312	162,090,785
Other Assets	2,365,780	2,365,780	2,150,053
Deferred Charges:			
Unamortized Debt Discount and Expense (Net)	8,613,433	8,107,721	(104,829)
Other	1,980,597	1,980,597	1,714,597
Total Deferred Charges	10,594,030	10,088,318	1,609,768
	$1,131,325,097	$1,086,848,650	$864,756,887

SUBSIDIARY COMPANIES

Appendix C

T OCTOBER 31, 1946

Liabilities and Capital

	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
Long Term Debt:			
Subsidiary Companies	$ 285,857,867	$ 285,857,867	$204,150,258
Cities Service Company:			
5% Convertible Gold Debentures due 1950	40,578,100		
5% Gold Debentures due 1958	25,840,500	25,840,500	
5% Gold Debenture due 1963	5,125,000	5,125,000	
Refunding 5% Gold Debenture Bonds due 1966	9,618,700	9,618,700	
5% Gold Debentures due 1969	19,326,000	19,326,000	
3% Debentures, due Jan. 1, 1977		115,246,950	90,246,950
Total Long Term Debt of Cities Service Company	100,488,300	175,157,150	90,246,950
Total Long Term Debt	386,346,167	461,015,017	294,397,208
Capital Stock:			
Subsidiary Companies:			
Preferred Stock in hands of Public and Accrued Undeclared Cumulative Dividends thereon	49,099,741	49,099,741	13,270,988
Minority Common Stockholders' Interest	30,133,927	30,133,927	25,515,833
Total Subsidiary Companies	79,233,668	79,233,668	38,786,821
Cities Service Company:			
$6 Cumulative Preferred Stock, N. P. V.—560,600 Shares	56,060,000		
$6 Cumulative Preference BB Stock, N. P. V.—17,700 Shares	1,770,000		
60¢ Cumulative Preference B Stock, N. P. V.—86,000 Shares	860,000		
	58,690,000		
Common Stock Equity:			
Common Stock, $10 P. V.—3,702,000 Shares	37,020,000	37,020,000	37,020,000
Capital Surplus	33,831,392	33,831,392	33,831,392
Earned Surplus (since Dec. 31, 1937)	125,055,901	86,891,360	125,363,922
	195,907,293	157,742,752	196,215,314
Total Cities Service Co.	254,597,293	157,742,752	196,215,314
Total Capital Stock	333,830,961	236,976,420	235,002,135
Current Liabilities (exclusive of long term debt due within one year)	75,941,173	73,311,567	46,730,636
Other Liabilities	5,461,741	5,461,741	4,851,013
Reserves:			
Depletion, Depreciation and Replacements	296,679,366	296,679,366	270,932,627
Accrued Undeclared Cumulative Dividends on Preferred and Preference Stocks of Cities Service Company to December 31, 1937	19,661,150		
Other	13,404,539	13,404,539	12,843,268
Total Reserves	329,745,055	310,083,905	283,775,895
	$1,131,325,097	$1,086,848,650	$864,756,887

NOTES:—see Appendix B, page 29.

	Years Ended		
	1938	1939	1940
Income:			
Income on bonds and indebtedness of subsidiary companies	$10,734,779	$ 8,755,450	$ 9,976,516
Dividends on preferred and common stocks of subsidiary companies	3,570,488	4,111,410	5,252,529
Interest and dividends on other investments	1,771,401	2,068,930	1,608,394
Interest on notes and accounts receivable, and sundry receipts	1,860	1,652	850
Net profit on securities of subsidiary, affiliated and other companies sold	383,112	210,944	718,769
Excess of par over book value of debentures of Cities Service Company retired through sinking fund	1,586,806	987,087	664,878
Total Income	18,048,446	16,135,473	18,221,936
Expenses:			
Administrative and management expenses	758,629	805,408	991,982
General, legal and other expenses	807,241	804,246	795,863
Taxes, other than taxes on income	(3)	(3)	(3)
Depreciation of furniture and fixtures	41,520	37,423	35,802
Total expenses	1,607,390	1,647,077	1,823,647
Gross Income (before provision for Federal Income Tax)	16,441,056	14,488,396	16,398,289
Interest and Other Charges:			
Interest on debentures and guaranteed bonds	9,133,397	9,127,493	8,744,796
Interest on notes and accounts payable and other obligations	308,052(4)	7,354	—
Amortization of debenture discount and expense	575,089	559,565	540,568
Federal and State taxes on debenture interest coupons	380,816	404,589	333,241
Provision for impairment of investment in a subsidiary company	—	—	—
Provision for contingencies	200,000	—.	—
Total interest and other charges	10,597,354	10,099,001	9,618,605
Net Income (before provision for Federal Income Tax)	5,843,702	4,389,395	6,779,684
Provision for Federal Income Tax	550,000	165,024	—
Net Income	5,293,702	4,224,371	6,779,684
Dividend Requirements on Preferred and Preference Stocks	5,533,000	4,550,397	3,782,720
Balance of Net Income	$ (239,298)	$ (326,026)	$ 2,996,964
Times interest and other charges earned, after provision for Federal income taxes	1.50	1.42	1.70
Times interest and other charges and preferred and preference stock dividend requirements of Cities Service Company earned, after provision for Federal income taxes	.99	.98	1.22
Accumulated Dividend Arrears at End of Period	32,583,135	30,937,338	30,385,000

Notes:

(1) Giving effect to the Plan.

(2) To reflect the sale of The Toledo Edison Company, The Ohio Public Service Company, Spokane Gas and Fuel Company, Federal Light and Traction Company, and the Doniphan County Light and Power Company and the application of estimated proceeds therefrom of $85,000,000 to the retirement of the remaining outstanding 5% Debentures, aggregating $59,910,200 principal amount, and the retirement of $25,000,000 principal amount of 3% Debentures due 1977.

Appendix D

OMPANY

STATEMENTS

December 31,					Twelve Months Ended October 31, 1946		
1941	1942	1943	1944	1945	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
$ 9,875,110	$ 9,568,922	$ 8,246,283	$ 8,235,259	$ 7,073,008	$ 5,142,544	$ 5,142,544	$ 5,142,504
4,881,533	1,778,725	5,119,859	6,811,125	9,079,681	12,598,626	12,598,626	11,808,491
1,994,470	1,782,045	1,644,478	1,664,640	1,800,977	1,840,751	1,840,751	1,840,751
18,144	9,944	8,860	29,993	90,921	4,664	4,664	4,664
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
16,769,257	13,139,636	15,019,480	16,741,017	18,044,587	19,586,585	19,586,585	18,796,410
1,036,888	1,052,608	1,038,343	1,143,356	1,204,879	1,306,142	1,306,142	1,306,142
744,584	686,585	752,319	732,150	897,500	1,210,592	1,210,592	1,210,592
240,104	103,530	108 733	110,671	139,858	201,767	201,767	201.767
31,938	32,336	15,914	10.231	37,487	60,000	60,000	60,000
2,053,514	1,875,059	1,915,309	1,996,408	2,279,724	2,778,501	2,778,501	2,778,501
14,715,743	11,264,577	13,104,171	14,744,609	15,764,863	16,808,084	16,808,084	16,017,909
8,378,151	7,986,682	7,635,733	7,400,714	7,426,529	6,084,103	6,466,849	2,707,408
—	7,812	—	—	—	—	—	—
513,955	491,010	468,166	453,489	452,960	380,324	165,028	—
147,407	145,270	143,222	119,242	128,495	117,996	38,421	—
—	—	—	—	745,000	745,000	745,000	745,000
402,500	—	—	—	—	—	—	—
9,442,013	8,630,774	8,247,121	7,973,445	8,752,984	7,327,423	7,415,298	3,452,408
5,273,730	2,633,803	4,857,050	6,771,164	7,011,879	9,480,661	9,392,786	12,565,501
374,000	113,000	195,000	252,000	270,000	372,000(5)	368,500(5)	495,500(5)
4,899,730	2,520,803	4,662,050	6,519,164	6,741,879	9,108.661	9,024,286	12,070,001
3,532,200	3,531,725	3,524,910	3,521,670	3,521,510	3,521,510	—	—
$ 1,367,530	$(1,010,922)	$ 1,137,140	$ 2,997,494	$ 3,220,369	$ 5,587,151	$ 9,024,286	$12,070,001
1.52	1.29	1.57	1.82	1.77	2.24	2.22	4.50
1.11	.92	1.10	1.26	1.26	1.51	—	—
32,163,650	35,637,775	39,229,030	42,630,600	46,150,550	49,085,050	—	—

(3) "Taxes, other than taxes on income" included with "Federal and State taxes on debenture interest coupons".

(4) Includes $197,916 interest on guaranteed bonds classified in other years as indicated.

(5) Includes $54,000 of special charges equivalent to estimated reduction of Federal income tax applicable to call premium and other costs on retired securities.

CITIES SERVICE COMPANY
CONSOLIDATED IN

	Years Ended		
	1938	1939	1940
Gross Operating Revenues:			
Crude and refined oils	$121,905,200	$122,689,744	$135,747,066
Natural gas	38,584,561	40,146,725	42,959,788
Electricity	48,180,283	50,765,899	52,894,424
Manufactured gas	2,065,220	2,076,943	2,165,754
Railway and bus	1,461,805	1,613,780	1,767,625
Heating, Ice and water	1,421,586	1,395,323	1,382,047
Real estate rentals	1,718,009	1,681,863	1,773,466
Contract fees	—	—	—
Total Gross Operating Revenues	215,336,664	220,370,277	238,690,170
Operating and Other Expenses:			
Operating expenses	131,575,460	132,211,257	144,277,963
Maintenance and repairs	10,640,603	10,145,202	10,871,411
Provision for depletion, depreciation and replacements	25,936,493	28,649,605	28,994,957
Taxes, other than taxes on income	14,272,284	14,308,181	14,050,822
Total operating and other expenses	182,424,840	185,314,245	198,195,153
Net Operating revenue	32,911,824	35,056,032	40,495,017
Other Income	10,174,309	7,085,997	5,496,582
Gross Income (before provision for taxes on income)	43,086,133	42,142,029	45,991,599
Interest and Other Charges (exclusive of interest charges on funded debt of Cities Service Company):			
Interest on funded debt	13,160,382	11,885,835	11,480,078
Interest on notes and accounts payable	1,983,487	2,369,144	1,865,702
Amortization of debt discount and expense	1,396,810	1,164,726	1,158,378
Dividends (paid or accrued) on subsidiary companies preferred stock in hands of public	6,024,690	5,734,169	5,614,375
Proportion of net income of subsidiaries applicable to minority interests	926,839	1,089,385	548,368
Other charges	397,660	460,558	325,203
Total interest and other charges	23,889,868	22,703,817	20,992,104
	19,196,265	19,438,212	24,999,495
Interest Charges on Funded Debt of Cities Service Co:			
Interest on debentures in hands of public	8,938,787	8,659,147	8,173,542
Amortization of debenture discount and expense	575,089	559,565	540,568
Total Interest charges on Funded Debt of Cities Service Co.	9,513,876	9,218,712	8,714,110
	9,682,389	10,219,500	16,285,385
Provision for Taxes on Income:			
Federal normal and surtaxes	3,667,874	3,630,758	6,357,356
Federal excess profit taxes	—	—	—
State and foreign income and excess profit taxes	—	—	—
Total provision for taxes on income	3,667,874	3,630,758	6,357,356
	6,014,515	6,588,742	9,928,029
Special charges equivalent to estimated reduction of Federal income tax applicable to call premium and other costs on retired securities	—	—	—
	6,014,515	6,588,742	9,928,029
Provision for Contingencies	200,000	—	—
	5,814,515	6,588,742	9,928,029
Provision for Post-War Adjustments	—	—	—
Net Income	5,814,515	6,588,742	9,928,029
Preferred and Preference Dividend Requirements of Cities Service Company	5,533,000	4,550,397	3,782,720
Net Income after Preferred and Preference Dividend Requirements of Cities Service Company	$ 281,515	$ 2,038,345	$ 6,145,309
Earnings per share applicable to Cities Service Company Common Stock[3]	$ .08	$ .55	$ 1.66
Times consolidated interest and other charges[4] earned after provision for taxes on income and special charges equivalent to estimated reduction of Federal income tax	1.18	1.21	1.39
Times consolidated interest and other charges[4] and preferred and preference dividend requirements of Cities Service Company earned after provision for taxes on income and special charges equivalent to estimated reduction of Federal income tax	1.01	1.06	1.18
Accumulated dividend arrears on preferred and preference stocks of Cities Service Company at end of period	$ 32,583,135	$ 30,937,338	$ 30,385,000

NOTES:

(1) Giving effect to the Plan.

(2) To reflect the sale of The Toledo Edison Company, The Ohio Public Service Company, Spokane Gas & Fuel Company, Federal Light & Traction Company and The Doniphan County Light & Power Company and the application of estimated

D SUBSIDIARY COMPANIES
IE STATEMENTS

Appendix E

December 31,					Twelve Months Ended October 31, 1946		
1941	1942	1943	1944	1945	Per Books	Pro Forma (Note 1)	Pro Forma Adjusted (Note 2)
$149,792,169	$157,145,858	$176,730,236	$233,563,444	$256,976,032	$224,418,357	$224,418,357	$224,418,357
4[illegible]050,534	48,809,942	43,438,331	43,580,430	46,906,700	47,090,053	47,090,053	45,820,009
5[illegible]736,626	62,547,073	52,527,105	49,852,211	44,598,533	41,364,886	41,364,886	—
,269,043	2,487,462	2,792,139	2,256,890	2,198,037	2,276,855	2,276,855	1,836,992
,020,674	5,668,414	5,775,418	4,779,448	4,268,006	3,654,286	3,654,286	3,642,666
,300,444	1,484,921	1,204,648	593,655	606,106	600,065	600,065	—
,777,899	1,826,685	1,807,330	1,942,875	2,668,815	2,929,573	2,929,573	3,012,352
—	227,781	267,988	263,000	260,000	6,500	6,500	6,500
260,[illegible]47,399	280,198,136	284,543,195	336,831,953	358,482,229	322,340,575	322,340,575	278,736,876
153,[illegible]56,567	159,984,776	172,387,944	219,628,250	236,059,175	206,417,946	206,417,946	187,301,781
11,[illegible]74,235	12,466,918	12,967,235	15,009,162	16,722,514	17,206,246	17,206,246	14,633,184
30,[illegible]33,242	31,860,305	31,540,751	39,550,184	52,038,257	37,858,797	37,858,797	33,999,882
15,[illegible]12,480	14,661,826	12,872,186	13,068,258	12,739,278	12,408,729	12,408,729	8,989,561
209,[illegible]06,524	218,973,825	229,768,116	287,255,854	317,559,224	273,891,718	273,891,718	244,924,408
51,[illegible]40,875	61,224,311	54,775,079	49,576,099	40,923,005	48,448,857	48,448,857	33,812,468
6,[illegible]06,463	3,574,876	5,861,562	3,775,050	3,903,558	4,977,615	4,977,615	4,365,764
57,[illegible]47,338	64,799,187	60,636,641	53,351,149	44,826,563	53,426,472	53,426,472	38,178,232
1[illegible]117,588	11,386,134	9,099,690	8,105,029	6,920,034	7,135,138	7,135,138	4,355,748
[illegible],321,293	2,078,727	1,651,356	2,039,045	2,329,088	1,552,955	1,552,955	1,494,945
,103,907	1,055,118	705,654	484,473	383,659	356,612	356,612	22,240
5,467,440	4,581,962	4,043,760	3,661,216	3,424,143	3,187,205	3,187,205	1,007,611
1,108,340	1,212,206	1,103,949	1,360,351	1,638,612	1,580,549	1,580,550	1,306,886
405,054	719,553	545,982	645,304	368,451	268,878	189,303	77,880
21,523,622	21,033,700	17,150,391	16,295,418	15,063,987	14,081,337	14,001,763	8,265,310
35,723,716	43,765,487	43,486,250	37,055,731	29,762,576	39,345,135	39,424,709	29,912,922
7,723,658	7,360,095	7,002,426	6,780,418	6,774,369	6,045,194	6,452,918	2,707,409
513,955	491,010	468,166	453,489	452,960	380,324	165,028	—
8,237,613	7,851,105	7,470,592	7,233,907	7,227,329	6,425,518	6,617,946	2,707,409
27,486,103	35,914,382	36,015,658	29,821,824	22,535,247	32,919,617	32,806,763	27,205,513
10,088,545	14,087,709	12,612,679	8,315,244	3,101,224	6,775,717	6,690,628	4,589,428
2,513,939	4,173,012	3,222,317	2,961,779	1,911,421	—	—	—
599,726	715,129	641,731	655,108	787,192	791,371	791,371	781,787
13,202,210	18,975,850	16,476,727	11,932,131	5,799,837	7,567,088	7,481,999	5,371,215
14,283,893	16,938,532	19,538,931	17,889,693	16,735,410	25,352,529	25,324,764	21,834,298
—	—	—	—	1,674,866	2,622,772	2,622,772	1,707,054
14,283,893	16,938,532	19,538,931	17,889,693	15,060,544	22,729,757	22,701,992	20,127,244
—	—	—	—	—	—	—	—
14,283,893	16,938,532	19,538,931	17,889,693	15,060,544	22,729,757	22,701,992	20,127,244
—	—	2,000,000	—	—	—	—	—
14,283,893	16,938,532	17,538,931	17,889,693	15,060,544	22,729,757	22,701,992	20,127,244
3,532,200	3,531,725	3,524,910	3,521,670	3,521,510	3,521,510	—	—
$ 10,751,693	$ 13,406,807	$ 14,014,021	$ 14,368,023	$ 11,539,034	$ 19,208,247	$ 22,701,992	$ 20,127,244
$ 2.90	$ 3.62	$ 3.79	$ 3.83	$ 3.12	$ 5.19	$ 6.13	$ 5.44
1.48	1.59	1.79	1.76	1.68	2.11	2.10	2.83
1.32	1.41	1.57	1.53	1.45	1.80	—	—
$ 32,163,650	$ 35,637,775	$ 39,129,030	$ 42,630,600	$ 46,150,550	$ 49,085,050	—	—

proceeds therefrom of $85,000,000 to the retirement of the remaining outstanding 5% Debentures, aggregating $59,910,200 principal amount, and the retirement of $25,000,000 principal amount of 3% Debentures due 1977.

(3) Based upon 3,702,000 shares outstanding as at October 31, 1946.

(4) Includes Preferred Stock Dividend Requirements of, and Minority Interest in, Subsidiary Companies.

Appendix F
Sheet 1

Cities Service Company

Investments at Carrying Values as at January 13, 1947

	Indebtedness	Preferred Stocks	Common Stocks	% of Outstanding Securities
Non-Utility Subsidiaries				
Arkansas Natural Gas Corporation:				
Common Stock	$	$	$ 4,482,944	74.96
Class A Common Stock			3,539,468	24.33
60¢ Cumulative Preferred Stock		3,690,465		39.80
Chesebrough Building Company:				
Common Stock			2,072,409	100.00
Cities Service Defense Corporation:				
Common Stock			10,000	100.00
Cities Service Oil Company of Argentina, S.A.C. el:				
Common Stock			78,826	100.00
Cities Service Oil Company (Pennsylvania):				
Common Stock			37,294,224	100.00
Cities Service Refining Corporation:				
Common Stock			24,000,000	100.00
Community Traction Company, The:				
8% Preferred Stock		—		99.57
1st Mortgage 6% Gold Bond	2,183,105			100.00
Notes Receivable	—			100.00
Empire Gas and Fuel Company:				
Common Stock			95,174,486	100.00
Penn-York Natural Gas Corporation:				
Common Stock			200,616	100.00
Sixty Wall Street:				
Common Stock			1,051,809	100.00
Sixty Wall Tower, Inc.:				
Common Stock			5,906,000	100.00
Zulia Petroleum Corporation:				
Common Stock			26,000	N.A.
Total Non-Utility Subsidiaries	2,183,105	3,690,465	173,836,782	
Electric Utility Subsidiaries				
Doniphan County Light and Power Company:				
Common Stock			14,000	100.00
Federal Light & Traction Company:				
Common Stock			21,666,894	64.71
$6.00 Preferred Stock		146,674		3.44
Ohio Public Service Company, The:				
Common Stock			6,225,211	100.00
Spokane Gas & Fuel Company:				
Common Stock			1,793,382	100.00
Toledo Edison Company, The:				
Common Stock			5,883,954	98.46
7% Preferred Stock		7,224		0.08
6% Preferred Stock		62		
5% Preferred Stock		3,585		
Total Electric Utility Subsidiaries	—	157,545	35,583,441	

Appendix F
Sheet 2

Cities Service Company

Investments at Carrying Values as at January 13, 1947

	Indebtedness	Preferred Stocks	Common Stocks	% of Outstanding Securities	
Gas Utility Subsidiaries					
Dominion Natural Gas Company, Ltd.:					
Common Stock			3,739,022	100.00	
Gas Service Company, The:					
Common Stock			8,479,298	100.00	
Republic Light, Heat and Power Company, Inc.:					
Common Stock			4,587,706	100.00	
Account Receivable	44,528			100.00	
Total Gas Utility Subsidiaries	44,528	—	16,806,026		
Other Investments					
Battery Park Realty Company:					
Mortgage Receivable	43,000			N.A.	
Brightman Manufacturing Company, The:					
Common Stock			—	98.51	
1st Preferred Stock		—		95.59	
2nd Preferred Stock		—		100.00	
7% Bonds				N.A.	
Cities Service Oil Company — France:					
Common Stock			50,000	100.00	
Comptible, S.A.:					
Common Stock			—	100.00	
Greeley Square Building Company:					
Common Stock			—	11.39[1]	
6% Bonds due 1951					
Guyaquill & Quito Railway Company:					
5% Bonds due 1932				[2]	
Mexico-Eastern Oil Company:					
Common Stock			—	100.00	
Account Receivable	20,000			100.00	
Mexico-Petrolene & Asphalt Company:					
Common Stock			—	100.00	
Sabino-Gordo Petroleum:					
Common Stock			—	100.00	
Sinclair Panama Oil Corporation:					
Common Stock			24,826	50.00	
Account Receivable	200,000			100.00	
Tri City Gas Company, The:					
Common Stock			1	49.00	
United Fuel Investments, Ltd.:					
Class B Preferred Stock		7,529		[2]	
War Emergency Pipe Line Company:					
Common Stock			1,000	9.09	
Total Other Investments	263,000	7,529	75,827		
Totals	$2,490,633	$3,855,539	$226,302,076		$232,648,248
Profits and Losses (net) on Sales of Certain Public Utility Investments Held in Suspense pending disposition of other like holdings					(1,700,027)
Total Investments and advances at January 13, 1947					230,948,221[3]
Add: Reduction in carrying value of Investments and advances in —					
Dominion Natural Gas Company					65,588
Gas Service Company Group (including Kansas City and Wyandotte County Gas)					5,873,077
Total Investments and Advances at October 31, 1946					$236,886,886[3]

[1] Acquired as a basket transaction.
[2] Less than 5% owned.
[3] Subject to a Reserve for Adjustment of Investments of $6,600,000.

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission, held at its office in the City of Philadelphia, Pa., on the 24th day of April, 1947.

IN THE MATTER OF CITIES SERVICE COMPANY File No. 54-153 (Public Utility Holding Company Act of 1935)	ORDER APPROVING PLAN UNDER SECTION 11(e)

Cities Service Company ("Cities"), a registered holding company, having filed a Plan pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935 for the simplification of its corporate structure; and

The Commission having issued its Notice of Filing and Order for Hearing on said Plan, appropriate notice having been given to all interested persons, and public hearings having been held, at which hearings all interested persons were afforded an opportunity to be heard; and

Cities having amended said Plan prior to the close of said hearings and notice of the filing thereof and opportunity for hearing thereon having been given to all interested parties; and

Cities having requested the Commission (1) to find that the Plan is necessary to effectuate the provisions of Section 11(b) of the Act and is fair and equitable to the persons affected thereby, and to make an order approving the Plan and containing appropriate recitals conforming to the requirements of Section 1808(f) and Supplement R of the Internal Revenue Code, as amended, and (2) to apply to an appropriate court, as provided by Section 11(e) of the Act, to enforce and carry out the terms and provisions of the Plan; and

The Commission having considered the record and having this day made and entered its Findings and Opinion herein, and having found the Plan necessary to effectuate the provisions of Section 11(b) of the Act and fair and equitable to the persons affected thereby and deeming it appropriate to grant the request of Cities that the Commission make application to an appropriate court to enforce and carry out the terms and provisions of the Plan:

IT IS ORDERED, pursuant to Section 11(e) and the other applicable provisions of the Act and the Rules and Regulations thereunder, that the Plan and the steps and transactions involved in the consummation thereof are necessary to effectuate the provisions of Section 11(b) of the Act and fair and equitable to the persons affected thereby, and hereby are approved, and the applications and declarations comprised therein are hereby granted and permitted to become effective, subject to reservations of jurisdiction with respect to the reasonableness and appropriate allocation of all fees and expenses and other remunerations incurred and to be incurred in connection with the Plan and the consummation thereof, and to entertain such further proceedings, to make such supplemental findings, and to take such

further action as may be necessary in connection with the Plan, the transactions incident thereto, and the consummation thereof, and subject further, to the terms and conditions prescribed in Rule U-24.

IT IS FURTHER ORDERED that this order shall not be operative to authorize the consummation of any of the transactions proposed in the Plan until an appropriate United States District Court shall, upon application thereto, enter an order enforcing such Plan.

The Commission deeming it appropriate to grant the request of Cities regarding the inclusion in this order of appropriate recitals and specifications conforming to the applicable provisions of the Internal Revenue Code, as amended:

IT IS FURTHER ORDERED AND RECITED, that the steps and transactions itemized below involved in the consummation of the Plan are necessary or appropriate to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935, and are necessary and appropriate to effectuate the integration or simplification of the holding company system, of which Cities Service Company is a member, and hereby authorized and approved:

(1) The issuance by Cities of its 3% Sinking Fund Debentures due 1977 in an aggregate principal amount not to exceed $115,246,950 and its Interim Certificates (representing interests of less than $100 in such Debentures) and the exchange by Cities with the holders of its Preferred Stock, Preference BB Stock and Preference B Stock, of said Debentures, Interim Certificates and cash, as hereinafter specified, for the 560,600 outstanding shares of its Preferred Stock, the 17,700 outstanding shares of its Preference BB Stock and 86,000 outstanding shares of its Preference B Stock, and all rights appertaining thereto including all dividend arrears thereon, on the basis of $196.50 principal amount of Debentures for each share of Preferred Stock, $193.50 principal amount of Debentures for each share of Preference BB Stock, and $19.35 principal amount of Debentures for each share of Preference B Stock; Interim Certificates to be issued in denominations of $10 or multiples thereof for amounts less than $100 and amounts of less than $10 to be paid in cash, and any such holder to receive cash only to the extent that the entire amount to which he is entitled cannot be satisfied in Debentures and Interim Certificates;

(2) The exchange by Cities prior to January 1, 1950 with the holders of said Interim Certificates, of 3% Sinking Fund Debentures due 1977 for Interim Certificates when combined in amounts aggregating $100 or multiples thereof;

(3) The sale or purchase by Cities prior to January 1, 1950 of Interim Certificates as provided in the Plan;

(4) The sale by Cities after January 1, 1950 of the 3% Sinking Fund Debentures due 1977 theretofore issuable to holders of shares of Preferred Stock, Preference BB Stock and Preference B Stock, not theretofore exchanged for such Debentures and the distributions to such holders of their pro rata share of such proceeds, plus such other cash, if any, as they may be entitled to upon surrender of their certificates prior to January 1, 1953, after which date any of such moneys not theretofore collected by such holders will revert to Cities; and

(5) The sale by Cities after January 1, 1950 of the 3% Sinking Fund Debentures due 1977 for which Interim Certificates then outstanding are exchangeable and the distribution to the holders thereof of their pro rata share of such proceeds upon the surrender of their Interim Certificates prior to January 1, 1953, after which date any of such moneys not theretofore collected by such holders will revert to Cities.

By the Commission.

ORVAL L. DUBOIS,
Secretary

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IN THE

District Court of the United States for the District of Delaware

IN THE MATTER OF CITIES SERVICE COMPANY	Civil Action No. 1028

ORDER ENFORCING PLAN

A certain plan to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 (hereinafter called the "Act") having been filed with the Securities and Exchange Commission (hereinafter referred to as the "Commission") pursuant to Section 11(e) of the Act by Cities Service Company (hereinafter referred to as the "Company"), a registered holding company under the Act; said plan having been modified and amended by an amended plan filed with the Commission on February 20, 1947 (which plan as amended will be hereafter referred to as the "Plan"); the Commission, after notice and opportunity for hearing, having found the Plan necessary to effectuate the provisions of subsection (b) of Section 11 of the Act and fair and equitable to the persons affected thereby, and having, by an appropriate order dated April 24, 1947, approved the Plan; the Company having requested that the Commission apply to an appropriate court to enforce and carry out the terms and provisions of the Plan; the Commission on April 25, 1947 having filed with this court an application to enforce and carry out the terms and provisions of the Plan; this Court, by Order dated April 25, 1947, having fixed May 27, 1947, as the date for hearing upon the Plan, and having prescribed the notice to be given of such hearing, the time within which objections might be made to the Plan, and the manner of making such objections; it appearing that due and sufficient notice of said hearing was given in accordance with the provisions of said Order of the Court dated April 25, 1947; said hearing having been held on May 27, 1947; the Commission, the Company and certain holders of preferred and preference stock having appeared at said hearing by their respective counsel in support of said application and no one having appeared in opposition thereto; all interested persons having been afforded an opportunity for hearing; and the Court having duly considered the Plan and the record herein and being fully advised in the premises;

IT IS HEREBY FOUND, ORDERED, ADJUDGED AND DECREED:

(1) This Court adopts, as its findings of fact and conclusions of law, the Findings and Opinion of the Commission dated April 24, 1947, Exhibit E to the Commission's application herein.

(2) This Court approves the Plan as fair and equitable and as appropriate to effectuate the provisions of Section 11 of the Act.

(3) To the extent necessary to enforce and carry out the terms and provisions of the Plan and for the purpose of enforcing and carrying out the terms and provisions thereof, this Court hereby takes exclusive jurisdiction of the Company and of its assets whether now owned or hereafter acquired and wherever located.

(4) The Company shall retain possession of its assets and continue the operation of its business through its directors, officers, agents and employees in accordance with its Certificate of Incorporation,

as amended, and its By-Laws, except as may be otherwise provided by this Order or by any subsequent order herein; and the Company may enter into any transactions not inconsistent with the Plan and this Order, including, without prejudice to the generality of the foregoing, the filing of appropriate applications, declarations and notices with the Commission, in conformity with the Act and with the rules, regulations and orders promulgated thereunder, in all cases where such filing and the entry of appropriate orders by the Commission would be required if this Court had not taken such jurisdiction.

(5) The Company, acting by or through its directors, officers and agents, is hereby authorized, ordered and directed to take and cause to be taken as soon as practicable, in accordance with the provisions and subject to the terms and conditions of the Plan, all action necessary or advisable to consummate and carry out the Plan and the steps and transactions contemplated therein in accordance with the terms and provisions thereof, including without limiting the generality of the foregoing, all action necessary or appropriate to carry into effect the steps and transactions specified in paragraphs numbered (1) to (5), inclusive, of said Order of the Commission and to redeem and retire in accordance with the terms and conditions of the Plan the $40,578,100 principal amount of its outstanding 5% Convertible Gold Debentures due 1950.

(6) Upon the entry of this Order all rights of the holders of the outstanding Preferred Stock $6 Cumulative, Preference BB Stock, and Preference B Stock of the Company, except to receive 3% Sinking Fund Debentures, Interim Certificates and cash in accordance with the provisions of the Plan, shall cease and determine; and the President or any Vice President and the Secretary or an Assistant Secretary of the Company are hereby authorized, ordered and directed, without further action by the Directors or Stockholders of the Company, to execute, acknowledge and file such certificate or other documents under the applicable provisions of the General Corporation Laws of the State of Delaware (including Section 77A thereof) as may be necessary or appropriate to reduce the capital of the Company by an amount equal to the aggregate stated value of said outstanding Preferred and Preference Stocks of the Company.

(7) Jurisdiction is generally reserved to the Court to entertain such further proceedings, to make such further findings, to enter such supplemental orders and to take such further action as it may deem necessary or appropriate in connection with the Plan, the transactions incident thereto and the consummation thereof.

(8) All security holders of the Company and all other persons are hereby permanently enjoined and restrained from doing any act or taking any action interfering or tending to interfere with these proceedings, or with the enforcement or carrying out of any of the terms and provisions of the Plan or of this Order, or with compliance with the Order of the Commission approving the Plan or with this Order, including the commencement or prosecution of any action, suit or proceeding, at law or in equity, or under any statute, in any court or before any executive or administrative officer, commission or tribunal, other than such proceedings before the Commission or this Court as may be appropriate under the Act or the rules and regulations promulgated thereunder, and such review, if any, in any appropriate Circuit Court of Appeals as may be provided by law.

(9) Upon consummation of the Plan the Company may apply for an order releasing and discharging it and its assets from the jurisdiction of this Court.

By the Court

(s) PAUL LEAHY
U. S. District Judge

dated May 27th, 1947
Wilmington, Delaware

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- -x

CITIES SERVICE COMPANY, :

Plaintiff, :

v. : AFFIDAVIT

UNITED STATES OF AMERICA, : 67 Civ. 4606

Defendant. :

- -x

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

WILLIAM A. GILL, being duly sworn, deposes and says:

1. That he is Vice President of Standard Research Consultants, Inc., with offices at 345 Hudson Street, New York, New York.

2. That Standard Research Consultants, Inc. is a business consulting firm providing professional industrial, financial and management consulting services to industrial, public utility and railroad companies, legal and accounting firms, estates, insurance companies, banks, hotels, publishing firms, retail organizations, government agencies, and others.

3. That until June of 1969 Standard Research Consultants, Inc. was a wholly-owned subsidiary of Standard & Poor's Corporation, and that from the aforesaid date to the present time Standard Research Consultants, Inc. has been a subsidiary of The American Appraisal Company.

4. That Standard & Poor's Corporation, with whom Standard Research Consultants, Inc. still maintains a close working relationship, was founded in 1860 and is the largest company of its kind gathering, collating and publishing information on industry, general business, corporations, securities, investments and economic situations.

5. That The American Appraisal Company engages in the valuation of all types of property for various purposes, having been established some 70 years ago, with its present headquarters in Milwaukee, Wisconsin and branch offices in approximately 35 major cities in the United States and Canada.

6. That he has been employed by Standard Research Consultants, Inc. since 1954 and that during the course of such employment he has prepared numerous studies which have included: the valuation of securities of corporations for estate, gift and income tax purposes and investment purposes as well as for purposes of minority stockholder suits in corporate mergers; the determination of fair market value of tangible and intangible assets of corporations for excess profits tax purposes; evaluations of working capital needs of various corporations; the determination of economic feasibility of new enterprises; determinations of going concern value for purposes of acquisition as well as for purposes of recapitalization plans; and the determination of a fair rate of return for public utilities.

7. That prior to his employment by Standard Research Consultants, Inc. he was employed for nine years in the field

of public accounting as a Senior Accountant, his experience during such employment having included the initiation and supervision of various accounting, auditing and advisory assignments for commercial, municipal and public school clients.

8. That prior to his active military service during the period 1942 to 1945, his professional experience included performance of services as a cost and general accountant for manufacturing and insurance concerns.

9. That he is a graduate of University College, Rutgers University, and holds a Bachelor of Science degree in Business Administration.

10. That he is a Certified Public Accountant in the State of New Jersey and a Public School Accountant in the State of New Jersey.

11. That he is a Senior Member of the American Society of Appraisers; a member of the American Institute of Certified Public Accountants; a member of the New Jersey Society of Certified Public Accountants; a member of the National Association of Accountants; and a member of the American Accounting Association.

12. That he has testified as an expert witness in various proceedings, including proceedings before United States District Courts for the Northern District of California, the Northern District of Illinois, the District of New Jersey, the Southern District of New York, and the Southern District of Ohio; the United States Court of Claims; the Tax Court of the United States; the Orphan's Court of Lebanon County, Pennsylvania; the Legislative Financial Committee of the State of New Mexico; and

the Appellate Tax Board, Department of Corporations and Taxation, State of Massachusetts.

13. That in May of 1969 counsel for plaintiff herein retained him for purposes of determining the fair market value as of May 27, 1947, of the following outstanding shares of preferred and preference capital stock of Cities Service Company:

Class	Number of shares outstanding
Preferred $6.00 cumulative, no par	560,600
Preference BB $6.00 cumulative, no par	17,700
Preference B $0.60 cumulative, no par	86,000

14. That during the regular course of his employment by plaintiff he undertook the aforesaid determination of the fair market value of the Cities Service Company capital stock set forth in paragraph 13 hereof.

15. That he is fully familiar with and has considered all the facts and circumstances surrounding and giving rise to the issuance by plaintiff on May 28, 1947 of $115,246,950 aggregate principal amount of its 3% Sinking Fund Debentures due 1977 in exchange for all the outstanding shares of its preferred and preference capital stock as set forth in paragraph 13 hereof, including, but not limited to:

a) The economy of the United States during the period 1930 through 1947, inclusive, as more fully described in Plaintiff's Exhibit 1-A appended hereto and incorporated herein by this reference.

b) The history of the public utility industry with particular emphasis on its experience under the Public Utility Holding Company Act of 1935 as more fully described in Plaintiff's Exhibit 1-B appended hereto and incorporated herein by this reference.

c) The history of Cities Service Company with particular emphasis on: the history and nature of its business; its experience under the Public Utility Holding Company Act of 1935; its operating results over the period 1935 through 1946, inclusive; its capital structure from inception through May 27, 1947; and the trading activity in its various securities over the 1935-1947 period as more fully described in Plaintiff's Exhibit 1-C appended hereto and incorporated herein by this reference.

16. That he is fully familiar with and has carefully considered the facts set forth in the Affidavit of Robert J. Casey, counsel for plaintiff, appended to Plaintiff's Response to Defendant's Motion For Summary Judgment as Plaintiff's Exhibit 2.

17. That he is fully familiar with and has carefully considered the Affidavit of William H. Bassett appended to Plaintiff's Response to Defendant's Motion For Summary Judgment as Plaintiff's Exhibit 4.

18. That he is fully familiar with and has carefully considered the various Exhibits appended to Defendant's Motion For Summary Judgment, more particularly Defendant's Exhibits "A" through "H", inclusive.

19. That in valuing the 560,600 shares of plaintiff's preferred $6.00 cumulative no par stock, the 17,700 shares of plaintiff's preference BB $6.00 cumulative no par stock, and the 86,000 shares of plaintiff's preference B $0.60 no par stock, for all of which plaintiff issued $115.246.950 aggregate principal amount of its 3% Sinking Fund Debentures due 1977 on May 28, 1947, he has taken into consideration, among other things, all of the factors set forth in paragraphs 15 through 18, inclusive, supra, together with the factors set forth in the various Exhibits referred to in paragraphs 15 through 18, inclusive, supra.

20. That as the result of the consideration detailed in paragraph 19, supra, he has concluded:

(a) In general, the financial condition of Cities Service improved significantly over the period January, 1935 to October 31, 1946. Nonetheless, at all times pertinent to the period of investigation, analysis, and study, the preferred and preference shares of Cities Service, were speculative in nature. While the market prices on the New York Stock Exchange for these preferred and preference shares were supported by active trading during the period January, 1943 through May, 1947. However, from November 20, 1946 these prices were dependent on the value of the consideration to be received in exchange for such shares; i.e. the 3% Sinking Fund Debentures in the aggregate principal amount of $115,246,950.

(b) That a valuation of the Cities Service preferred and preference shares as of May 27, 1947 predicated on the plan of simplification as amended fails to reflect the true inherent worth of such shares in light of the fact that from November 20, 1946 to May 27, 1947, the value of these shares was totally dependent upon the value of the announced consideration to be received in exchange therefor; i.e. the new Cities Service Debentures.

(c) In order to determine the fair market value of the Cities Service preferred and preference shares on their own merits as a security as of May 27, 1947, it is necessary to analyze such shares at that point in time prior to any proposed plan of simplification.

(d) That in his opinion as of May 27, 1947, the fair market value of the Cities Service preferred and preference shares, on their own merits as a security, without reference to any announced plan of simplification, was as set forth below:

Security	Fair Market Value
$6.00 Preferred	$147.50 per share
$6.00 Preference BB	138.00 per share
$0.60 Preference B	13.75 per share

Dated: January 27, 1970
New York, New York

William A. Gill

Subscribed and sworn to before me
on this 27th day of January, 1970

Notary Public

TIMOTHY C. QUINN, JR.
NOTARY PUBLIC, State of New York
No. 31-4508450
Qualified in Queens County
Commission Expires March 30, 1971

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Plaintiff's Exhibit 1-A
to the Affidavit of
William A. Gill

ECONOMY OF THE UNITED STATES

1930-47

A. General

In the years from 1930 to 1947, the economy of the United States experienced two periods of depression and a boom based on the demands of a nation making preparations for war and then at war.

The economic collapse of 1930-32 came suddenly, reversing the business outlook which appeared so promising as late as 1929. Business in general, which believed that the economy should regulate itself, was forced to seek government help. Although government aid had been offered in the 19th Century and there had always been some regulation, such acts were regarded as exceptions to, or minor modifications of, the normal rule of economic law. In 1932, The Reconstruction Finance Corporation made loans to, or investments in preferred stocks of banks, railroads and other hard-pressed companies. The National Industry Recovery Act of a year later was also designed to aid the businessman.

However, other laws passed during the first Roosevelt administration were regulatory, especially The Securities Act of 1933, The Income Tax Law of 1935, and The National Labor Relations Act of the same year.

The recovery measures instituted by the government failed to bring lasting prosperity. The uptrend in the economy from 1933 to 1937 was generally believed to be the result of government spending. A move to balance the federal budget was followed by a severe recession in 1938.

A turning point in the relations between government and business occurred as the economy made preparations for the world-wide conflict which began in 1939. Government spending for the products of private industry replaced that for economic recovery. The level of these expenditures far exceeded those of the depression period and added a stimulus to private investment. Full employment resulted, and production reached an unprecedented level.

At the end of the war, businessmen found themselves in a new era. Wages reached an all-time high, and consumer demand was beyond filling. Consumer goods which had been deferred during the war could not be produced fast enough.

Set forth in the following sections are some basic statistics relative to the economy of the United States during this 17-year period.

B. Population and Employment

Between 1930 and 1947 the population of the United States increased by almost 21 million from 123.2 million to 144.1 million. This represented an increase of 17% in 17 years. Between 1930 and 1941 the military forces comprised but a few hundred thousand persons. Beginning in 1941 the armed forces

comprised from 1.8 million to over 12 million in 1945. In 1946 - and 1947 reductions due to the end of World War II dropped the level of service people to about 3 million in 1946 and 1.6 million in 1947.

The civilian labor force increased by some 10.3 million or by 21% in the 17 years from 1930 to 1947. Unemployment reached a peak of 12.8 million in 1933, about 25% of the total labor force. Unemployment declined annually to 7.7 million in 1937 before rising to 10.4 million in 1938. The buildup in the defense and war effort reduced unemployment in 1939 and subsequent years to 1944 when only 670,000 were not employed or only 1.2% of the total labor force. With the return to a peacetime economy unemployment increased, but was still less than 4% of the work force in 1946 and 1947.

C. Gross National Product

The gross national product represents the total value of currently produced goods and services flowing to government and consumers and for purposes of capital formation to business.

As reported by the United States Department of Commerce, the Gross National Product for the 17-year period 1930-47 was as set forth below:

GROSS NATIONAL PRODUCT - 1930-47

Year	Total	Personal Consumption Expenditures	Gross Private Domestic Investment	Government Purchases of Goods and Services	
				Total	Federal
	In Billions of Dollars				
1930	90.9	70.8	10.2	9.2	1.4
1931	75.9	61.1	5.4	9.2	1.5
1932	58.3	49.2	0.9	8.1	1.5
1933	55.8	46.3	1.3	8.0	2.0
1934	64.9	51.9	2.8	9.8	3.0
1935	72.2	56.2	6.1	9.9	2.9
1936	84.7	62.5	10.5	11.7	4.8
1937	90.2	67.1	11.4	11.6	4.6
1938	84.7	64.5	6.3	12.6	5.3
1939	90.4	67.5	9.0	13.1	5.2
1940	100.5	72.0	13.0	13.9	6.2
1941	125.3	82.3	17.2	24.7	16.9
1942	159.6	90.8	9.3	59.7	52.0
1943	192.6	101.7	4.6	88.6	81.2
1944	210.6	110.4	5.7	96.6	89.0
1945	213.1	121.7	9.1	83.1	75.0
1946	203.7	143.7	24.6	30.7	20.7
1947	229.6	164.4	27.8	28.7	16.4

The decline in gross national product in the early 1930's reflects the severity of the economic collapse. After some improvement from 1934 to 1937, the drop in 1938 indicates the second depression of the decade. The increases in gross product from 1939 to 1945 were the result of the expenditures for our preparation and ultimate participation in World War II.

Personal consumption expenditures, the largest component of gross national product, paralleled the trend of gross

national product in the 1930's. However, with the large expenditures needed for the war effort in the period from 1940 to 1944, personal consumption expenditures, while increasing, were held in check by government controls. However, with the ending of the war and the dropping of controls, personal consumption expenditures increased by $11 billion in 1945 over 1944 and in the two subsequent years by over $21 billion over the preceding year. Personal consumption expenditures totaled $164.4 billion in 1947, or $54 billion over the level of such expenditures in 1944. Gross national product totaled $229.6 billion in 1947 or $19 billion over the level of 1944.

Gross private domestic investment declined drastically during the early years of the depression, with less than a billion dollars reported in 1932. After recovering slowly to reach a level of $11.4 billion in 1937, this expenditure declined to $6.3 billion in the 1938 depression. Recovery came more rapidly and private investment reached $17.2 billion in 1941. Wartime restrictions and scarcity of materials restricted investment during the 1942-45 period, but with the end of the conflict such investment increased dramatically in 1946.

The economic recovery activities of the federal, state and local governments during the depression years are reflected in the increase in such expenditures during the 1930's. World War II expenditures for war goods are reflected in the increase in federal expenditures which reached $89 billion in 1944. With the end of the war, federal expenditures for goods and services declined to $16.4 billion by 1947. However, expenditures by state and local governments increased to $10 billion in 1946

and $12.3 billion in 1947, after being held to less than $8 billion during most of the war years.

D. Business Enterprise

The growth of corporations in number and size during the 17-year period 1930-47 is also reflective of the national economy during this period. As reported by the Internal Revenue Service, this growth was as set forth below:

CORPORATION STATISTICS

Year	Number of Corporations(a)		Total Assets	
	Total	Public Utilities	Total	Public Utilities
	In Thousands		In Billions of $	
1930	403.2	17.2	334.0	80.5
1931	381.1	16.5	296.5	72.3
1932	392.0	17.5	280.1	72.1
1933	388.6	17.7	268.2	69.0
1934	410.6	21.3	301.3	68.5
1935	415.2	21.1	303.2	66.5
1936	415.7	20.7	303.2	62.7
1937	416.9	20.8	303.4	64.6
1938	411.9	18.6	300.0	60.8
1939	412.8	18.7	306.8	60.2
1940	413.7	18.7	320.5	56.7
1941	407.1	18.4	340.5	58.5
1942	383.5	16.9	360.0	63.6
1943	366.9	16.2	389.5	64.9
1944	363.1	16.2	418.3	65.0
1945	375.0	16.7	441.5	63.2
1946	440.8	18.6	454.7	63.8
1947	496.8	20.4	494.6	68.0

Note: (a) Based on number of tax returns with balance sheets.

The number of corporations dropped by 22,000 in 1931 from the preceding year. By 1934 there were 410,000 corporations. Thereafter until 1942 there were no significant changes in the numbers which ranged from 407,100 in 1941 to a high of 416,900 in 1937. However, in the World War II period there was a decline

in numbers to a low of 363,100 by 1944 before rapidly increasing to 496,800 by 1947.

The total assets of all corporations declined from $334 billion in 1930 to $268.2 billion in 1933. Assets increased to just over $300 billion in 1934, and remained in a narrow range of from $300 to $306.8 billion in the following five years. From a level of $320.5 billion in 1940, assets of all corporations increased annually and totaled $494.6 billion by 1947.

There were 17,200 public utility corporations in 1930 which, after declining to 16,500 in the following year, increased to 21,100 in 1935. From that point until 1944 there was a decline in the number of public utilities to 16,200 in 1943 and 1944. In 1945 the number rose to 16,700, and by 1947 there were 20,400.

Total assets of public utility corporations dropped to $72.3 billion in 1931, a decline of $8.2 billion from the preceding year. This decline in total assets of public utilities continued, with only one interruption in 1937, and by 1940, total $56.7 billion. The assets of utility companies increased to $65 billion by 1944 before declining to $63.2 billion in 1945, and in 1947 amounted to $68 billion.

E. Capital Issues

The issuance of bonds, notes and capital stocks is a further indicator of business and economic conditions. As reported by the Commercial and Financial Chronicle, such issuances, for the 17-year period 1930-1947, were as set forth below:

CAPITAL ISSUES

1930-47

Year	Total	Total Corporate	Public Utilities
	In Millions of Dollars		
1930	7,677.0	5,473.2	2,566.2
1931	4,022.9	2,589.0	1,583.9
1932	1,730.3	643.9	540.3
1933	1,053.7	381.6	92.7
1934	2,212.3	491.1	158.4
1935	4,752.3	2,267.4	1,283.8
1936	6,254.3	4,631.9	2,125.3
1937	4,001.3	2,433.7	827.5
1938	4,459.2	2,140.5	1,222.6
1939	5,853.1	2,196.2	1,327.0
1940	4,805.9	2,762.6	1,274.1
1941	5,545.9	2,618.8	1,383.0
1942	2,114.5	1,042.5	467.2
1943	2,228.2	1,080.9	399.1
1944	4,295.9	3,181.1	1,384.3
1945	8,046.2	6,258.6	2,397.4
1946	8,728.0	6,652.1	2,114.6
1947	9,706.7	6,274.5	3,127.6

Note: Preferred stocks of no par value and all common stocks are taken at offering price, other issues at par.

Again the severe effects of the depression are indicated by the decline from over $7.6 billion of capital issues in 1930 to just about $1 billion in 1933.

Corporate issues declined from some $5.5 billion in 1930 to $381.6 million in 1933. Public utility issues declined from $2.5 billion to $93 million in the same period. In the subsequent three years, issues for capital purposes increased before dropping severely in 1937. Corporate issues dropped again in 1938, but total and public utility issues were up in that year. In 1942 and 1943 capital issues were severely restricted by the wartime economy. Beginning in 1944, capital issues increased in total in each year through 1947 as did public utility capital financing. However, total corporate issues declined in 1947 from the level of 1946.

F. Money Rates and Bond Yields

Short-term interest rates and bond yields for the highest rated corporate bonds experienced a drastic decline during the 1930-1947 period. As reported by the United States Department of Commerce, interest rates on 4 to 6 months' prime commercial paper declined from 3.59% per annum in 1930 to 0.75% by 1935. These rates went as low as 0.53% in 1941, and in the entire period from 1935 to 1946 were always below 1%. In 1947 the rate moved up to 1.03%.

Similarly, bank rates on short-term business loans declined from 4.9% in 1930 to a low of 2% in 1941. In 1946 and 1947 the rate was 2.1%. From 1935 to 1947 the rate was always below 3% and usually closer to 2%.

Ninety-day-time loans on the New York Stock Exchange declined from 2.94% in 1930 to 0.55% in 1935. The rate remained at 1% for the years 1937 through 1945 before moving up to 1.16% in 1946 and 1.38% in 1947.

The yields on corporate bonds of the highest quality (rated Aaa by Moody's) ranged from 5.01% in the year 1932 to 2.53% in 1946. Yields on lower medium grade corporate obligations (rated Baa by Moody's) ranged from 9.30% in 1932 to 3.05% in 1946. Bonds of an inferior grade (unrated) required an even higher rate of interest. In general, from 1932 to 1946 the trend in corporate bond yields was downward.

Plaintiff's Exhibit 1-B
to the Affidavit of
William A. Gill

PUBLIC UTILITY INDUSTRY

A. Early History of Electric Public Utility Industry

The electric power industry began in 1879 with the first central station established in San Francisco to furnish power to its arc-lamp system. In that same year Thomas A. Edison invented the first commercially practical incandescent lamp and demonstrated a complete lighting system using the lamp. The development of a practical alternating current system by George Westinghouse in 1886 permitted an electrical current to be economically transmitted over long distances.

Despite these inventions and discoveries the electric utility industry in 1890 just barely existed. Cities were so small and few as to require no special facilities for transportation, communication, heating or lighting. The street electric railway or "trolley" was in its infancy with the first line established in Richmond, Virginia in 1888.

However, in the decades that followed, the growth in the urban population became the force that brought the public utility business into being. Whereas the urban population in 1880 was just over 14 million, by 1930 the population in urban areas numbered almost 69 million.

An indication of this growth is apparent from the data on the net production of electric energy by central stations and by ownership set forth below:

NET PRODUCTION OF ELECTRIC ENERGY

Year	Industrial Establishments	Electric Utilities		Total Utility and Industrial
		Publicly Owned	Privately Owned	
	Millions of Kilowatt Hours			
1902	3,462	196	2,311	5,969
1907	8,259	289	5,573	14,121
1912	13,183	537	11,032	24,752
1917	17,991	1,039	24,399	48,429
1920	17,154	1,689	37,716	56,559
1925	23,215	2,766	58,685	84,666
1930	23,525	5,003	86,109	114,637

Sources: U.S. Department of Commerce; Historical Statistics of the United States.

Many of the electric utility companies started out primarily as traction or railway companies with electric operations secondary. By 1922, however, the gross revenues of central electric light and power stations exceeded the revenues of electric railways. The number of electric systems in the United States steadily increased up to 1917, when a decline set in. The decrease reflects a consolidation movement which began about this time and continued throughout the 1920's. While this movement took place through merger and lease, the leading means of consolidation was through the use of the holding company.

B. Holding Companies

From the consolidation of small operating companies into larger ones, the next step was to combine operating companies into holding company systems.

An indication of the rapid growth of holding company systems in the electric power industry is the number of holding companies incorporated for various periods:

Prior to 1900	5 companies
1900-1909	11 companies
1910-1919	7 companies
1920-1929	46 companies
1930	2 companies

The rapid growth of the holding company in the electric utility industry was due to several factors. The expansion of the industry up to 1930 required large amounts of capital funds especially equity money. The holding company was especially effective in supplying such relatively difficult-to-obtain funds.

There were other advantages the holding company system brought to the operating companies such as the economies of large scale generation plants, savings due to group purchasing of goods and services for many operating companies, and the lower cost of financing accruing to the larger enterprise.

The unsound financial structures of many utility holding companies left them ill-prepared to weather the rigors of the depression. Between September 1, 1929 and April 15, 1936, a total of 53 holding companies with combined securities of a par value of $1.7 billion went into receivership or bankruptcy. The need for action was demonstrated by the fall of the giant Insull system and the Associated Gas and Electric Company. Thus, the Congress enacted the Public Utility Act (Wheeler-Rayburn Act) in 1935.

C. Holding Company Act

The Public Utility Act of 1935 consisted of two parts, Title I of the Act (known as the Public Utility Holding Company Act) gave the Securities and Exchange Commission (created in 1933 to have jurisdiction over all securities sold in interstate

commerce) increased jurisdiction over public utility securities and the power to simplify and integrate public utility holding companies. Title II extended the jurisdiction of the Federal Power Commission over the interstate transmission of electricit

The heart of the Public Utility Holding Company Act (Title I) and the major corrective provision was contained in Section 11. This section provided for the physical disintegration and financial simplification of holding company systems. In effect, holding company systems were limited to two tiers of holding companies.

The Public Utility Holding Company Act was perhaps the most stringent corrective measure ever applied to American business. The reorganization of a 14-billion-dollar industry was undoubtedly one of the greatest tasks ever attempted by an administrative agency.

D. Developments Under the Act

Within a few months of the passage of the Act on August 26, 1935, over 50 lawsuits were brought challenging it as unconstitutional. The constitutionality of the Act was upheld by a District Court in a suit filed by Electric Bond and Share Company, and an appeal was affirmed by the Supreme Court in March, 1938. Thereafter, practically all of the holding companies registered with the SEC as required.

However, very little was being done voluntarily by the companies toward working out plans for integration and simplifica-

tion. The SEC found it necessary to institute formal proceedings to administer the law. By June of 1940 law suits had been started against nine major utility systems owning 58% of the assets registered under the Act.

The Act was not specific as to how divestment and simplification were to be accomplished in each case. This was only accomplished on a case by case basis through the route of administrative hearings. As a result of proceedings and findings of the SEC, litigation occurred which established basic principles having an important effect on all public utility investors.

One such principle involved the treatment of junior security holders in a situation where full and immediate liquidation of a company would only be able to satisfy the claims of senior security holders but where, on a going-concern basis, there would be potential values for junior security holders. The Commission held that the process of compliance with the Act should not mature liquidation preferences to the exclusion of junior security holders, and allowed the latter to participate in the reorganization if this were fair and equitable. The courts upheld the SEC, declaring the rights of stockholders in a solvent company ordered to distribute assets among stockholders should be evaluated on the basis of a going concern and not on the basis of a liquidation, because charter provisions became inoperative in the simplification under the Act.

While some decisions of the Commission were being litigated, and the principles involved not resolved by the courts

until years later, the investing public was cognizant of the efforts of the Commission and the effect on the securities of holding companies.

Standard & Poor's Corporation in its May 5, 1944 Industry Surveys - Utilities stated under the caption "Federal Regulation - Important:"

> "The most important federal regulatory body is the SEC, which has powers under Section 11 of the Holding Company Act that will probably result in ultimate liquidation of most interstate holding company systems and complete physical and corporate rearrangement of other systems.
>
> "Some progress has already been made along this line, but accomplishment of the entire integration program will be slow, because of the magnitude of the problems involved.
>
> "In general, it may be concluded that SEC policies will be motivated by a desire to strengthen the position of the operating companies, if necessary, at the expense of holding company security holders."

Plaintiff's Exhibit I-C
to the Affidavit of
William A. Gill

DESCRIPTION OF CITIES SERVICE COMPANY

A. History and Nature of the Business

Cities Service Company was incorporated under the laws of Delaware in September, 1910 as a holding company to acquire the securities of electric light and power, natural and artificial gas, steam heating, water, electric street and interurban railway and other public utility corporations. As of December 31, 1935 the company owned directly, or indirectly, a controlling stock interest in more than 115 operating subsidiaries with operations in 39 states, Canada and foreign countries.

The public utility subsidiaries, numbering over 75, supplied light and power, gas and other services in 21 states and Canadian territories. Utility service was supplied to 914,000 customers and more than 1,000 municipalities.

The natural gas subsidiaries were engaged in the production, transportation, and distribution of natural gas, and operated principally in Kansas, Oklahoma, Missouri, Arkansas, Louisiana, Colorado, New York and Ontario, Canada. The company had a 26.6% interest in a 900 mile - 24 inch natural gas pipeline between Texas and Chicago which was completed in 1931. Peoples Gas Light & Coke Co. contracted to purchase the gas for distribution in Chicago.

The more than 30 petroleum subsidiaries were engaged in the production, transportation, refining and marketing of crude oil and its products. The more important producing properties were located in Oklahoma, Kansas and Texas. The subsidiaries owned and operated 11 refineries and 1,700 miles of oil pipeline. nterests in other oil pipeline systems were held.

Petroleum products were marketed through subsidiaries a d dealers in 9,750 communities in 39 states, Canada and foreign c untries, principally England and Argentina.

B. Effect of Holding Company Act on Cities Service Company

On July 3, 1941, the SEC instituted a Section 11(b)(1) roceeding with regard to Cities Service Company and all its ubsidiaries. After hearings the SEC issued its opinion and order on May 5, 1944. The order directed Cities Service to comply with Section 11(b)(1) by reducing the operations of its system to certain gas distribution properties located in the Mid-Continent section and certain gas production and transmission properties. The order provided, however, that the retention in the system of all of its nonutility holdings was not foreclosed if Cities Service should choose to comply with Section 11(b)(1) by disposing of its holdings in all utility holding companies.

The company elected to retain its nonutility properties, and on October 12, 1944 the SEC entered a supplemental order providing, in substance, that Cities Service might dispose of its interests in utility properties in lieu of complying with the provisions of the earlier order. In its annual report for the

year ended June 30, 1945, the SEC reported that Cities Service had disposed of its interests in 32 subsidiaries since May 5, 1944. The June 30, 1946 annual SEC report disclosed that interests in an additional seven subsidiaries had been disposed of, and that a program of refinancing certain subsidiaries preparatory to the divesting of its interests in Cities Service Power & Light Company was under way.

The order of May, 1944 also directed Arkansas Natural Gas Corp., a subsidiary holding company of Cities Service, to confine its operations to the natural gas business and dispose of its interests in its nonutility subsidiaries.

On March 4, 1940 proceedings were instituted under Section 11(b)(1) with reference to the holding company system of Cities Service Power & Light Company (Power & Light), a holding company subsidiary of Cities Service Company. On August 17, 1943 Power & Light was ordered to dispose of its interest in 43 companies, including Federal Light & Traction Company (Federal) and its 14 subsidiaries, and to confine its operations to the electric utility business conducted by certain subsidiaries in Ohio. Power & Light disposed of its interest in all but five of its subsidiaries which were transferred to the parent Cities Service upon the dissolution of Power & Light. This was approved by the SEC on August 29, 1946. Cities Service under its plan of simplification of November, 1946 indicated it would divest itself of these five subsidiaries.

Pursuant to the SEC order of August 17, 1943, Federal Light & Traction was required to confine its operations to the electric utility business conducted by subsidiaries in New Mexico and Colorado. On March 3, 1944 the Commission granted Federal an option to retain its utility system either in New Mexico and Colorado, or those in Arizona. Federal disposed of all subsidiaries, except the four operating entirely in New Mexico, and merged these four into one company. Federal was liquidated in October, 1947.

As of August 30, 1946, Cities Service Power & Light Company was dissolved and its remaining holdings were transferred to the parent company. These holdings consisted of:

The Ohio Public Service Company	-	100% of the common stock
The Toledo Edison Company	-	98% of the common stock
Federal Light & Traction Company	-	64% of the common stock

Cities Service planned to dispose of its interests in the above utility companies. The principal holdings which the company planned to retain are set forth below:

CITIES SERVICE COMPANY

PRINCIPAL HOLDINGS TO BE RETAINED

NOVEMBER, 1946

A 110

Industry and Name	Activity	Per Cent of Common Stock Owned %
Oil and Wholesale Natural Gas:		
Empire Gas and Fuel Company	Holding company	100
Cities Service Gas Company	Natural gas producing and transportation	100
Cities Service Oil Company (Delaware)	Oil producing, refining and marketing	100
Empire Pipeline Company	Oil pipeline	100
Cities Service Oil Company Limited	Oil marketing	100
Richfield Oil Corporation	Oil producing, refining and marketing	31.37
Natural Gas Pipeline Company of America	Natural gas Pipeline	28.56
Texoma Natural Gas Company	Natural gas producing and pipeline	28.56
The Texas-Empire Pipe Line Company	Oil pipeline	50
Cities Service Oil Company (Pennsylvania)	Oil transportation and marketing	100
Cities Service Refining Corporation	Oil refining	100
Arkansas Natural Gas Corporation	Holding company	51.5
Arkansas Fuel Oil Company	Oil producing and marketing	100
Arkansas Pipeline Company	Oil pipeline	100
Orange State Oil Company	Oil marketing	100
Real Estate:		
Sixty Wall Tower, Inc.	Own 70 Pine Street, N.Y.	100
Sixty Wall Street	Own 60, 52 and 54 Wall Street, New York	100
Utilities:		
The Gas Service Company	Natural gas distribution, Kansas City	100
Republic Light, Heat and Power, Inc.	Natural gas production and distribution, New York	100
Dominion Natural Gas Company Limited	Natural gas producing, transportation and marketing - Canada	100

Note: The table does not include all the companies in which Cities Service has an interest.

Sources: Cities Service Company; November 20, 1946 Plan of Simplification.

C. Review of Financial Condition

At October 31, 1946 Cities Service (the parent compa[illegible]) had current assets of $88,952,000 of which $85,756,000 was cas[illegible] This represented an increase of $39 million in cash and curre[illegible] assets in the 10 months since December 31, 1945.

Net current assets were $74,122,000 at October 31, 1946 (23.6% of total net assets) compared to $36,570,000 (11.3% of total net assets) 10 months earlier.

Investments and advances totaled $236,887,000 at October 31, 1946 compared to $2[illegible],286,000 at December 31, 1945. Securities were carried at cost or less and advances at cost. The decline reflects the divestment of the properties as required under the SEC orders. These assets declined from 87.4% of total net assets at the 1945 year end to 75.3% at October 31, 1946.

Total net assets were $314,393,000 at the latest date compared to $3[illegible]3,060,000 at December 31, 1945.

The investment consisted of $100,488,000 of long-term debt, $58,690,000 of preferred and preference stocks at stated values and $155,215,000 of common stock, surplus and reserves. Included in the reserves was $19,661,000 representing accrued and undeclared dividends on the preferred and preference stocks to December 31, 1937. The total arrearages on these issues at October 31, 1946 was $49,085,050.

Certain significant changes in the financial condition of the company occurred during the 10-month period December 31, 1945 through October 31, 1946 as set forth below:

	$000
Additions:	
Increase in net current assets	37,552
Decrease in long-term debt	35,000
	72,552
Deductions:	
Decrease in investments and advances	45,399
Decrease in other assets	820
	46,219
Increase in stockholders' equity	26,333

Over the years 1935 to 1945 Cities Service balance sheets reflected assets, debt and capital stock as reflected below:

CITIES SERVICE COMPANY

REVIEW OF SIGNIFICANT BALANCE SHEET ITEMS - 1935-45

As At December 31	Total Net Assets	Net Current Assets	Long-Term Debt	Preferred and Preference Stocks
	In Thousands of Dollars			
1935	600,749	3,199	194,827	110,463
1936	585,381	6,476	189,807	107,749
1937	564,944	5,452	190,824	96,856
1938	359,228	26,677	185,436	82,488
1939	341,094	32,769	180,352	67,994
1940	333,104	33,176	172,128	59,000
1941	329,014	26,955	163,726	58,870
1942	325,935	28,031	156,319	58,775
1943	323,370	21,173	148,975	58,722
1944	328,405	25,822	147,489	58,692
1945	323,060	36,570	135,488	58,690
		Relative to Total Net Assets		
		%	%	%
1935		0.5	32.4	18.4
1936		1.1	32.4	18.4
1937		1.0	33.8	17.1
1938		7.4	51.6	23.0
1939		9.6	52.9	19.9
1940		10.0	51.7	17.7
1941		8.2	49.8	17.9
1942		8.6	48.0	18.0
1943		6.5	46.1	18.2
1944		7.9	44.9	17.9
1945		11.3	41.9	18.2

Source: Moody's Manual of Investments.

The decrease in total net assets from $600,749,000 at the end of 1935 to $323,060,000 by December 31, 1945 reflects primarily the effect of the divestment program. Net current assets, after the 1935-37 period, increased to $33,176,000 or 10% of total net assets by December 31, 1940 and after holding at from $21.1 million to $28 million in the next four year-end dates, rose to $36.6 million at December 31, 1945.

While total net assets were declining by about $277,000,000 between the year end of 1935 and 1945, long-term debt was reduced by $59,000,000 while the preferred and preference stocks (at stated values) declined by $52,000,000.

D. Review of Operating Results

The parent company's income was primarily in the form of interest on the bonds and dividends on the stock of its subsidiary companies. Interest and dividends on other investments was also received. Its total gross income and the net income after taxes for the years 1935-46 are reflected below:

CITIES SERVICE COMPANY

(PARENT COMPANY ONLY)

INCOME DATA - 1935-46

Year	Total Gross Income	Net Income After Taxes
	- - - - In Thousands of Dollars - - -	
1935	21,664	5,856
1936	20,716	6,965
1937	23,484	9,616
1938	18,046	5,294
1939	16,135	4,224
1940	18,222	6,780
1941	16,769	4,900
1942	13,140	2,521
1943	15,019	4,662
1944	16,741	6,519
1945	18,045	6,742
1946	19,260	9,786

Source: Moody's Manual of Investments.

The company's consolidated income account reflected the following items of gross and net operating revenues, net income after provision for federal income taxes and the time charges and preferred dividends earned:

CITIES SERVICE COMPANY

AND CONSOLIDATED SUBSIDIARIES

INCOME DATA AND RATIOS - 1935-46

Year	Gross Operating Revenue	Net Operating Revenue	Net Income	Times Overall Charges and Preferred Dividends Earned
	In Thousands of Dollars			Times
1935	192,798	38,231	5,956	0.93
1936	193,594	42,377	6,965	1.01
1937	241,256	47,223	9,616	1.10
1938	215,337	32,912	5,815	1.02
1939	220,370	35,056	6,589	1.08
1940	238,690	40,495	9,928	1.19
1941	260,947	51,041	14,284	1.33
1942	255,622	52,400	16,114	1.44
1943	273,403	51,614	17,559	1.55
1944	331,384	47,862	17,875	1.58
1945	358,482	40,923	15,061	1.48
1946	333,175	53,469	27,253	2.08

Source: Moody's Manual of Investments.

E. Capitalization

At October 31, 1946, the funded debt and capital stock of Cities Service outstanding in the hands of the public were as follows:

Long-Term Debt:	
5% convertible gold debentures, due 1950	$ 40,578,100
5% gold debentures, due 1958	25,840,500
5% gold debentures, due 1963	5,125,000
Refunding 5% gold debenture bonds, due 1966	9,618,700
5% gold debentures, due 1969	19,326,000
Total debt	$100,488,300
Preferred Preference Stocks:	
Preferred stock $6 cumulative, no par, 560,600 shares, stated value $100.	$ 56,060,000
Preference BB stock $6 cumulative, no par, 17,700 shares, stated value $100.	1,770,000
Preference B stock $0.60 cumulative, no par, 86,000 shares, stated value $10.	860,000
Total preferred and preference stocks (at stated value)	$ 58,690,000
Common stock, $10 par value, 3,702,000 shares	$ 37,020,000

The preferred stock $6 cumulative was preferred as to dividends over the two classes of preference stocks and the common stock and the preference BB and preference B stocks ranking pari passu, were preferred as to dividends over the common stock.

On liquidation or dissolution whether voluntary or involuntary, the preferred stock was entitled to $100 per share plus unpaid accrued dividends before any distribution was made to other stockholders and the BB and B preference stocks were entitled to $100 per share and $10 per share respectively, plus unpaid accrued dividends, before any distribution could be made to the common stock.

The preferred BB stock and B stock were subject to redemption, in whole or in part, at any time, by the payment of an amount equal to $112, $106 and $10.60 per share respectively, plus unpaid accumulated dividends.

The preferred $6 cumulative stock was first issued in 1910 and the total shares authorized were 1,500,000, increased in 1919 from an original authorization of 1,000,000.

The stock had one vote per share. The initial cash dividend on this stock was paid January 1, 1911 and although payments were deferred in 1914 and 1916 and paid in scrip in 1921 and 1922 all such arrearages were paid by the end of 1922. Cash dividends were paid from 1922 to June, 1932 inclusive at the rate of $6 per annum. No dividends were paid from June, 1932 through 1946 with the exception of $3 per share payment in 1941.

The $6 cumulative preference BB stock had 600,000 shares authorized and paid its initial dividend on November 1, 1922. No dividends were paid from after June, 1932 through 1946. The stock had one vote per share.

There were 4,000,000 shares of $0.60 cumulative preference B stock authorized and the initial dividend was paid January 1, 1920. Dividends after June, 1921 and through September, 1922 were paid in scrip. After redeeming the scrip in October, 1922 cash dividends were resumed and paid through June, 1932. No dividends were paid from that time through 1946. The stock had voting rights of one-tenth vote per share.

All these issues had been changed to no par stock on April 26, 1927.

Except for their voting rights, the preferred stockholder had no protection regarding the issuance of new securities by the corporation. The total voting power of the preferred and preference issues amounted to 586,900 votes while the common stockholders had 1,851,000 votes.

F. Redemption of Preferred and Preference

The depression of the early 1930's had an effect on all businesses. Cities Service beginning in 1932 stopped paying cash dividends on its preferred and preference stocks. The prices of all securities declined severely and those of Cities Service were no exception.

With the prices of its preferred and preference stocks at levels far below their stated values an opportunity existed for the company to purchase such shares on the open market. Such purchases would also have the effect of cancelling arrearages on such shares as were reacquired.

Between 1933 and 1937, Cities Service acquired $22,864,300 in stated value of its preferred stock with total claims amounting to $26,383,100 for a cost of $8,307,100 or only about 31.5% of the total claims. The bulk of these purchases were in the years 1935, 1936 and 1937 when $7,977,200 of costs were incurred and $21,024,600 of the stated value was acquired. This active acquisition program was continued through 1940. Through this period, the cost of acquiring such shares never exceeded 47% of the total claims.

Cities Service began acquiring shares of its two preference issues in 1932. Of the total cost of $4,312,700 in the years 1932-37, $4,001,800 was incurred in 1932. None of the $6 preferred had been acquired in 1932, a year when cash dividends on the preferred and preference issues were paid through June.

During the years from 1933 to 1944, the corporation was able to acquire its preferred and preference shares at much less than their total claims. With one exception, the cost was always less than 50% in the years from 1933 to 1942.

G. Market Prices and Trading Activity

The preferred and preference issues were listed on the Boston Stock Exchange and were traded on the New York Curb Exchange. The annual range of high and low prices for these issues for the years 1935 through 1945 is set forth below:

CITIES SERVICE COMPANY

ANNUAL RANGE OF MARKET PRICES - 1935-45

Year	$6 Preferred		$6 Preference BB		$0.60 Preference B	
	High $	Low $	High $	Low $	High $	Low $
1935	47 1/4	6 1/8	43	6	4 3/8	5/8
1936	66	41 1/2	63	40	6 1/2	3 3/4
1937	60	15	58	13	5 7/8	1 1/2
1938	53 3/4	21 1/2	50 1/2	20	5	2
1939	66	43 1/2	62 1/2	37	6 1/4	3 7/8
1940	85	49	81 1/2	45	8	4 1/2
1941	83 1/2	48	72 5/8	48	7 1/2	2 1/4
1942	55	27	52	28 1/2	4 3/4	2 1/2
1943	98 1/4	51 1/4	96 1/2	48	11 7/8	4 3/4
1944	119 3/4	92 1/4	111 5/8	85 1/2	12 1/8	8 3/4
1945	145 1/8	117	142	110 3/4	13 7/8	11

Source: Moody's Manual of Investments - Utilities.

In the eight years from 1935 to 1942 inclusive none of the issues ever traded at prices as high as the stated values of the shares. The preferred stock sold as low as $6 1/8 in 1935 or just a few cents above its annual dividend rate.

The market prices of the preferred and preference issues on a monthly basis for the year 1946 and through May, 1947 are set forth in the following schedule:

CITIES SERVICE COMPANY

MONTHLY RANGE OF MARKET PRICES

JANUARY, 1946 - MAY, 1947

Year and Month	$6 Preferred		$6 Preference BB		$0.60 Preference B	
	High $	Low $	High $	Low $	High $	Low $
1946						
January	152 1/8	144	145	140	14 5/8	13 7/8
February	155	140	145	140 1/2	14 1/2	13 5/8
March	154 3/4	147	142	140 1/2	14 3/8	13 3/4
April	155	148 1/2	145	140 1/2	14 5/8	14
May	157	150	150	145 1/2	15	14 1/2
June	161 1/4	153 1/4	155	148	15 3/4	14 3/4
July	166	157 3/8	156	150	15 1/4	15 1/4
August	164 7/8	151	155	143	15 1/4	14 1/2
September	150 1/2	125	142 1/2	116	13 3/4	11 7/8
October	146	129	130	116	12 1/2	11
November	156	141	156	136	15 3/4	13 1/2
December	158 1/2	147	156	150	15 1/2	15 1/4
1947						
January	159 3/4	153 3/4	160	155 3/4	15 3/4	15 1/2
February	177	158 1/4	170	160	17 1/4	16 1/8
March	175 1/4	167 3/4	172	166 1/4	17 1/4	16 1/2
April	173 3/4	169 1/4	170	167 1/2	17	16 1/2
May	184 1/2	167 3/4	181 1/2	169	18 1/8	16 1/2

Source: The Wall Street Journal.

In February, 1947 the market prices of these issues increased significantly as they did again in May. The daily prices of these stocks in those two months showed the following pattern with regard to the $6 preferred issue:

	High $	Low $
February 1 to 10	162	158 1/4
February 11 to 20	177	161 1/2
February 21 to 28	173 3/4	169 3/4
May 1 to 20	175	167 3/4
May 21 to 27	179	169 1/2
May 28	182 1/4	179 1/4
May 29	184 1/2	183 1/8

The number of shares traded in the years 1943 to 1946, inclusive, and for the five months to May 31, 1947 are presented below together with the relationship of the trading activity to the shares outstanding:

CITIES SERVICE COMPANY

TRADING ACTIVITY - 1943-MAY, 1947

Year	$6 Preferred		$6 Preference BB		$0.60 Preference B	
	Shares Traded #	Per Cent of Outstanding (a) %	Shares Traded #	Per Cent of Outstanding (b) %	Traded #	Per Cent of Outstanding (c) %
1943	[illegible]2,000	27.1	1,970	11.1	30,100	35.0
1944	148,045	26.4	3,640	20.6	28,900	33.6
1945	105,650	18.8	4,670	26.4	19,000	22.1
1946	112,150	20.0	2,390	13.5	15,000	17.4
1947 (5 months)	117,050	20.8	10,570	59.7	20,400	23.7

Notes: (a) Based on 560,920 shares outstanding in 1943; 560,620 in 1964 and 560,600 in other years.
(b) Based on 17,700 shares outstanding.
(c) Based on 86,000 shares outstanding.

Source: The Commercial and Financial Chronicle.

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT

OF NEW YORK

- - - - - - - - - - - - - - - - - - X

CITIES SERVICE COMPANY, :

Plaintiff, :

v. : Civil Action, File No._____

UNITED STATES OF AMERICA, : COMPLAINT

Defendant. :

- - - - - - - - - - - - - - - - - - X

The above named Plaintiff for its Complaint hereby alleges as follows:

1. This is an action arising under the Internal Revenue Laws of the United States, of which this Court has jurisdiction pursuant to Title 28, United States Code, Section 1346(a)(1).

2. Plaintiff is a corporation duly organized and existing under the laws of Delaware, and maintains its principal office at 60 Wall Street, New York City, New York.

3. This action is brought for an overpayment of Federal income tax for the taxable years ended December 31, 1953 and 1954 in the respective amounts of $422,160.18, and $569,038.49, or in the alternative $1,225,691.89 and $1,161,071.49, or such further amounts as may be legally refundable, together with statutory interest thereon.

4. At all times pertinent hereto, Plaintiff has kept its books and filed its Federal income tax returns on the accrual basis, utilizing a calendar year.

5. Plaintiff timely filed its consolidated Federal income tax return for the taxable year ended December 31, 1953 under date of September 15, 1954 with the District Director of Internal Revenue, Lower Manhattan District, New York.

6. Said return as filed disclosed a Federal income tax liability of $21,875,518.20, which was paid to the aforesaid District Director in the amounts and on the dates as set forth below:

Date of Payment	Amount of Tax
March 15, 1954	$10,766,679.00
June 15, 1954	10,766,679.00
December 15, 1954	342,160.20
Total	$21,875,518.20

7. On March 23, 1962 the then Commissioner of Internal Revenue made the following additional assessment of income tax and interest thereon with respect to Plaintiff's taxable year ended December 31, 1953:

Tax	Interest
$736,596.63	$339,272.38

8. Said additional assessment was paid in full by Plaintiff on March 28, 1962 to the District Director of Internal Revenue, Manhattan District, New York.

9. Under date of March 24, 1964, Plaintiff timely filed with the District Director of Internal Revenue, Manhattan District, New York, a Claim For Refund (Form 843) for its taxable year ended December 31, 1953, in the amount of $139,201.10.

10. Plaintiff to date has had no formal notice of any action taken by Defendant, either allowing or disallowing said Claim For Refund of $139,201.10.

11. Inasmuch as more than six months have elapsed since the filing of said Claim For Refund, Plaintiff brings this action for its taxable year ended December 31, 1953 pursuant to the provisions of Section 6532(a)(1) of the Internal Revenue Code of 1954.

12. Plaintiff timely filed its consolidated Federal income tax return for the taxable year ended December 31, 1954 under date of September 14, 1955 with the District Director of Internal Revenue, Lower Manhattan District, New York.

13. Said return as filed disclosed a Federal income tax liability of $11,457,990.87, which was paid to the aforesaid District Director in the amounts and on the dates as set forth below:

Date of Payment	Amount of Tax
March 15, 1955	$ 5,750,000.00
June 15, 1955	5,750,000.00
Total	$ 11,500,000.00

14. On or about October 18, 1955, Plaintiff received from the aforesaid District Director a refund of tax in the amount of $42,009.13 together with interest thereon of $733.72 with respect to its taxable year ended December 31, 1954.

15. On or about October 25, 1961, Plaintiff filed with the District Director of Internal Revenue, Manhattan District, an amended consolidated Federal income tax return for its taxable year ended December 31, 1954, which reflected an additional tax due for such year in the amount of $75,085.30.

16. Plaintiff paid said additional tax of $75,085.30 on or about October 25, 1961, to the aforesaid District Director of Internal Revenue.

17. On or about November 23, 1962, the then Commissioner of Internal Revenue made the following additional assessment of income tax and interest thereon with respect to Plaintiff's taxable year ended December 31, 1954:

Tax	Interest
$ 783,271.95	$ 361,335.15

18. Said additional assessment was paid in full by Plaintiff on or about December 3, 1962, to the aforesaid District Director of Internal Revenue, Manhattan District, New York.

19. Under date of March 24, 1964, Plaintiff timely filed with the District Director of Internal Revenue,

Manhattan District, a Claim For Refund (Form 843) for its taxable year ended December 31, 1954, in the amount of $200,085.69.

20. Under date of February 10, 1966, Plaintiff timely filed with the District Director of Internal Revenue, Manhattan District, an Amended Claim For Refund (Form 843) for its taxable year ended December 31, 1954, in the amount of $468,129.65.

21. On or about October 25, 1966, Plaintiff received from the District Director of Internal Revenue, Manhattan District, a refund of tax in the amount of $59,909.02, together with interest thereon of $48,002.75, with respect to its taxable year ended December 31, 1954.

22. Under date of November 17, 1966, Plaintiff received by certified mail from the District Director of Internal Revenue, Manhattan District, a Statutory Notification of the disallowance in full of its aforesaid Claim For Refund in the amount of $200,085.69, and Amended Claim For Refund in the amount of $468,129.65, as provided in Section 6532 of the Internal Revenue Code of 1954, and accordingly brings this action for its taxable year ended December 31, 1954, pursuant to the provisions of Section 7422 of the Internal Revenue Code of 1954.

Count I

23. At all times pertinent hereto, Plaintiff has been a registered holding company under the Public Utility Holding Company Act of 1935 (hereafter referred to as the "Act").

24. As such Plaintiff was required to file, and did file on November 20, 1946, with the Securities and Exchange Commission (hereafter referred to as the "Commission") a Plan, pursuant to Section 11(e) of said Act, for the simplification of its corporate structure (hereafter referred to as the "Plan").

25. So far as material hereto, said Plan as amended on February 20, 1947, provided for the issuance by Plaintiff of $113,246,950 principal amount of its 3% Debentures due 1977 in exchange for all its outstanding preferred and preference capital stock.

26. Under date of April 24, 1947, an Order was issued by the Commission to Plaintiff to comply with the provisions of the Plan as amended, which Order recited that the issuance by Plaintiff of its aforesaid 3% Debentures in exchange for all its outstanding preferred and preference capital stock was necessary or appropriate to effectuate the provisions of Section 11(b) of the Act.

27. On May 27, 1947, the Plan became operative pursuant to an Order of Enforcement issued by the United States District Court for the District of Delaware.

28. On May 28, 1947, Plaintiff, in accordance with the Plan as amended, issued $115,246,950 aggregate principal amount of its 3% Sinking Fund Debentures due 1977 in exchange for all its issued and outstanding preferred and preference shares, as of the effective date of the Plan, as set forth below:

Class of Stock	Number of Shares	Principal Amount Debentures Per Share	Aggregate Principal Amount Debentures
$6 Preferred	360,600	$100.00	$110,157,900.00
$6 Preference BB	17,700	103.50	3,424,950.00
[illegible]	[illegible]	[illegible]	[illegible]
			$115,246,950.00

29. The aforesaid 360,600 shares of $6 Preferred capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of such issuance of $44,967,026.15.

30. The aforesaid 17,700 shares of $6 Preference BB capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of such issuance of $1,048,181.35.

31. The aforesaid 86,000 shares of $6d Preference B capital stock had been originally issued by Plaintiff at various times in consideration for cash and properties having

an aggregate fair market value at the time of such issuance of $749,439.95.

32. The aggregate fair market value of Plaintiff's aforesaid 560,600 shares of $6 Preferred capital stock, 17,700 shares of $6 Preference BB capital stock, and 86,000 shares of 60¢ Preference B capital stock, exchanged for said 3% Debentures pursuant to said Plan, was no more than $84,439,215.52.

33. During the taxable year ended December 31, 1953, Plaintiff retired $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures through purchases on the open market of said Debentures for an aggregate purchase price of $1,398,357.39.

34. During the taxable year ended December 31, 1954 Plaintiff retired $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures through purchases on the open market of said Debentures for an aggregate purchase price of $1,785,569.02.

35. As the result of its retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1953, Plaintiff sustained a loss in the amount of no less than $781,778.11, such loss being a deductible expense for said taxable year.

36. In the alternative, as the result of its retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended Decem-

ber 31, 1953, Plaintiff sustained a loss in the amount of no less than $284,785.38, such loss being a deductible expense for said taxable year.

37. In determining Plaintiff's Federal income tax liability for the taxable year ended December 31, 1953, the Commissioner of Internal Revenue erroneously failed to allow Plaintiff any deduction for the aforesaid loss of $781,778.11, or, in the alternative, of $284,785.38, incurred upon the retirement of $1,519,500.00 aggregate principal amount of its aforesaid 3% Debentures during said year.

38. As the result of its retirement of $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1954, Plaintiff sustained a loss in the amount of no less than $1,053,774.99, such loss being a deductible expense for said taxable year.

39. In the alternative, as the result of its retirement of $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures during the taxable year ended December 31, 1954, Plaintiff sustained a loss in the amount of no less than $463,107.55, such loss being a deductible expense for said taxable year.

40. In determining Plaintiff's Federal income tax liability for the taxable year ended December 31, 1954, the Commissioner of Internal Revenue failed to allow Plaintiff any deduction for the aforesaid loss of $1,053,774.99, or, in

the alternative, of $463,107.55, incurred upon the retirement of $1,805,900.00 aggregate principal amount of its aforesaid 3% Debentures during said year.

41. The actions of the Commissioner of Internal Revenue enumerated in paragraphs 37 and 40, supra, were erroneous, illegal and without warrant in law.

42. As the result of the facts set forth in this Count, there is due and owing from Defendant to Plaintiff for the taxable year ended December 31, 1953, the amount of $422,160.18, or, in the alternative, $153,734.11, and for the taxable year ended December 31, 1954, the amount of $569,038.49, or, in the alternative, $250,078.08, or such further amounts as this Court may find due and owing from Defendant to Plaintiff with interest thereon as provided by law.

Count II

43. Plaintiff repeats, reiterates and realleges paragraphs 1 through 34, inclusive, of this Complaint and incorporates such paragraphs herein by this reference.

44. By way of an alternative to the allegations set forth in Count I, paragraphs 35 through 42, supra, Plaintiff alleges its aforesaid 3% Debentures were issued at an aggregate discount of no less than $68,432,302.55, said discount being ratably amortizable over the life of said Debentures.

45. By way of a further alternative, and as an alternative to the allegations set forth in Count I, supra, Plaintiff alleges its aforesaid 3% Debentures were issued at an aggregate discount of no less than $30,787,734.48, said discount being ratably amortizable over the life of said Debentures.

46. As the result of the discount sustained by Plaintiff on the issuance of its 3% Debentures under the alternative allegation set forth in paragraph 44, supra, Plaintiff was entitled to a deduction for the amortization thereof for the taxable years ended December 31, 1953 and 1954, as well as to a deduction for each of such years for the unamortized portion of said discount attributable to Plaintiff's retirements therein of $1,519,500.00 and $1,805,900.00 aggregate principal amount of its 3% Debentures, said deductions being no less than the amounts as set forth below:

Year	Amortization of Discount	Unamortized Discount Attributable to Retirements
1953	$ 1,537,239.46	$ 732,510.33
1954	1,501,015.46	834,302.11

47. In determining Plaintiff's Federal income tax liability for the taxable years ended December 31, 1953 and 1954, the Commissioner of Internal Revenue failed to allow any deductions for the amounts set forth in paragraph 46, supra.

48. As the result of the discount sustained by Plaintiff on the issuance of its 3% Debentures under the alternative allegation set forth in paragraph 45, supra, Plaintiff was entitled to a deduction for the amortization thereof for the taxable years ended December 31, 1953 and 1954, as well as to a deduction for each of such years for the unamortized portion of said discount attributable to Plaintiff's retirement therein of $1,513,500.00 and $1,805,900.00 aggregate principal amount of its 3% Debentures, said deductions being no less than the amounts as set forth below:

Year	Amortization of Discount	Unamortized Discount Attributable to Retirements
1953	$ 691,122.50	$ 329,316.23
1954	674,814.71	375,078.97

49. In determining Plaintiff's Federal income tax liability for the taxable years ended December 31, 1953 and 1954, the Commissioner of Internal Revenue failed to allow any deductions for the amounts set forth in paragraph 43, supra.

50. The actions of the Commissioner of Internal Revenue enumerated in paragraphs 47 and 49, supra, were erroneous, illegal and without warrant in law.

51. As the result of the facts set forth in this Count, there is due and owing from Defendant to Plaintiff for the taxable year ended December 31, 1953, the amount of

$1,225,691.89, or, in the alternative, $551,033.91, and for the taxable year ended December 31, 1954, the amount of $1,251,071.49, or, in the alternative, $566,942.59, or such further amounts as this Court may find due and owing from Defendant to Plaintiff with interest thereon as provided by law.

52. Although repayment of the said amounts set forth in paragraphs 42 and 51, supra, has been demanded in the alternative, no part thereof has been credited, remitted, refunded or repaid to Plaintiff or to anyone on Plaintiff's account.

WHEREFORE, Plaintiff demands judgment against Defendant in either of the alternative principal amounts as set forth in paragraph 42, supra, or, in the alternative, in either of the alternative principal amounts as set forth in paragraph 51, supra, or such further amount as this Court may find to be legally due and owing by Defendant to Plaintiff, together with interest thereon as provided by law.

Robert J. Casey
120 Broadway
New York, New York 10005

OF COUNSEL:

Thomas E. Tyre
John A. Craig
Clark, Carr & Ellis
120 Broadway
New York, New York 10005

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- -X

CITIES SERVICE COMPANY, :

Plaintiff, :

v. : AFFIDAVIT

: 67 Civ. 4606

UNITED STATES OF AMERICA, :

Defendant. :

- -X

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

WILLIAM H. BASSETT, being duly sworn, deposes and says:

(1) That he has been in the employ of CITIES SERVICE COMPANY (hereinafter the Company) since 1955 and is presently employed as "Manager of the Stock Transfer Department" and "Assistant Secretary" of the Company, which titles and positions he has held since 1962.

(2) That between the years 1957 and 1958 and between the years 1958 and 1962 he served the Company as Manager of the General Accounting Department, and as Manager of the Foreign Accounting Department, respectively.

(3) That the Company has complete and available corporate records which record a detailed history of its capital structure.

(4) Tnat these corporate records set forth in complete detail data relating to the number of shares and respective issuance dates of it $6 Preferred, 60¢ Preference B and $6 Preference BB Capital Stock and the consideration paid into the Company upon such issuance.

(5) That the corporate records of the Company indicate that the $6 Cumulative Preferred Stock reacquired from 1932 to January 1, 1947 (date of issuance of 3% debenture), the par or stated value thereof, the cost of reacquisition, the excess of par or stated value over cost and accumulated dividends cancelled on shares reacquired is as set forth in Exhibit 4-A, which is attached hereto and made a part hereof.

(6) That the corporate records of the Company indicate that the 60¢ Cumulative Preference B Stock reacquired from 1932 to January 1, 1947 (date of issuance of 3% debenture), the par or stated value thereof, the cost of reacquisition, the excess of par or stated value over cost and accumulated dividends cancelled on shares reacquired is as set forth in Exhibit 4-B, which is attached hereto and made a part hereof.

(7) That the corporate records of the Company indicate that the $6 Cumulative Preference BB Stock reacquired from 1932 to January 1, 1947 (date of issuance of 3% debenture), the par or stated value thereof, the cost of reacquisition, the excess of par or stated value over cost and accumulated dividends cancelled on shares reacquired is as set forth in Exhibit 4-C, which is attached hereto and made a part hereof.

Dated: January 27, 1970
New York, New York

"Subscribed to and sworn to
before me on this 27th day
of January 1970."

TIMOTHY C. QUINN, JR.
NOTARY PUBLIC, State of New York

Notary Public Commission Expires March 30, 1971

CITIES SERVICE COMPANY

$6.00 Cumulative Preferred Stock Reacquired from 1932 to January 1, 1947 (Date of Issuance of 3% Debentures), the Par or Stated Value thereof, the Cost of Reacquisition, the Excess of Par or Stated Value Over Cost and Accumulated Dividends Cancelled on Shares Reacquired.

Acquired	Par Or Stated Value Reacquired	Cost of Reacquisitions	Excess of Par Or Stated Value Over Cost	Accumulated Dividends Cancelled on Shares Acquired To 12/31/37	Accumulated Dividends Cancelled on Shares Acquired 1/1/38-12/31/46
ar 1933	$ 1,136,542.92	$ 237,405.07	$ 899,137.85		
1934	703,133.00	92,530.00	610,603.00		
1935	7,868,630.00	1,935,251.97	5,933,378.03		
1936	2,457,235.00	1,281,978.00	1,175,257.00		
1937	10,698,800.00	4,759,903.50	5,938,896.50		
				3,518,792.50	
12/31/37	22,864,340.92	8,307,068.54	14,557,272.38		
1938	14,055,500.00	6,553,222.50	7,502,277.50	4,708,592.50	641,448.00
1939	14,085,800.00	7,998,703.00	6,087,097.00	4,718,743.00	1,371,877.50
1940	8,737,483.44	6,022,704.97	2,714,778.47	2,927,029.00	1,328,568.50
1941	130,000.00	81,195.00	48,805.00	43,550.00	24,050.00
1942	75,000.00	39,855.43	35,144.57	25,125.00	22,500.00
1943	53,000.00	49,873.00	3,127.00	17,755.00	17,755.00
1944	30,000.00	28,111.25	1,888.75	10,050.00	11,100.00
1945	2,000.00	2,842.00	(842.00)	670.00	960.00
	$60,033,124.36	$29,083,575.69	$30,949,548.67	$15,970,307.00	$3,418,259.00

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CITIES SERVICE COMPANY

60¢ Cumulative Preference B Stock Reacquired from 1932 to January 1, 1947 (Date of Issuance of 3% Debentures), the Par or Stated Value thereof, the Cost of Reacquisition, the Excess of Par or Stated Value Over Cost and Accumulated Dividends Cancelled on Shares Reacquired.

eacquired	Par Or Stated Value Reacquired	Cost of Reacquisitions	Excess of Par Or Stated Value Over Cost	Accumulated Dividends Cancelled on Shares Acquired To 12/31/37	Accumulated Dividends Cancelled on Shares Acquired 1/1/38-12/31/46
ar 1928	$ 770,000.00	$ 700,000.00	$ 70,000.00		
1932	1,350,541.22	1,185,519.06	165,022.16		
1933	16,130.00	2,277.14	13,852.86		
1934	17,380.00	3,525.25	13,854.75		
1935	79,500.00	18,009.75	61,490.25		
1936	108,000.00	64,222.50	43,777.50		
1937	90,000.00	40,955.00	49,045.00		
To 12/31/37	2,431,551.22	2,014,508.70	417,042.52	104,498.35	
1938	112,000.00	49,675.50	62,324.50	37,520.00	5,325.00
1939	217,400.00	115,124.50	102,275.50	72,829.00	21,900.00
1940	99,050.78	67,489.56	31,561.22	33,181.75	15,361.00
1942	10,000.00	4,927.50	5,072.50	3,350.00	300.00
	$2,870,002.00	$2,251,725.76	$618,276.24	$251,379.10	$42,886.00

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CITIES SERVICE COMPANY

$6.00 Cumulative Preference BB Stock Reacquired from 1932 to January 1, 194? (Date of Issuance of 3% Debentures), the Par or Stated Value thereof, the Cost of Reacquisition, the Excess of Par or Stated Value Over Cost and Accumulated Dividends Cancelled on Shares Reacquired.

Reacquired	Par Or Stated Value Reacquired	Cost of Reacquisitions	Excess of Par Or Stated Value Over Cost	Accumulated Dividends Cancelled on Shares Acquired To 12/31/37	1/1/38-12/31/4
Year 1932	$3,338,728.88	$2,816,298.42	$ 522,430.46		
1933	94,912.75	9,605.30	85,307.45		
1934	131,900.00	22,157.75	109,742.25		
1935	164,000.00	26,067.70	137,932.30		
1936	149,100.00	80,235.25	68,864.75		
1937	104,000.00	43,870.00	60,130.00		
To 12/31/37	3,982,641.63	2,998,234.42	984,407.21	219,991.00	
1938	200,000.00	84,503.05	115,496.95	67,000.00	8,720.00
1939	191,600.00	100,942.90	90,657.10	64,186.00	19,125.00
1940	157,741.12	101,503.47	56,237.65	52,829.50	23,629.00
1942	10,000.00	4,747.25	5,252.75	3,350.00	3,000.00
	$4,541,982.75	$3,289,931.09	$1,252,051.66	$407,356.50	$54,474.00

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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

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CITIES SERVICE COMPANY,

Plaintiff,

-against-

67 Civ. 4606

UNITED STATES OF AMERICA,

Defendant.

- -x

#36985

U.S. DISTRICT COURT
FILED
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S. D. OF N.Y.

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MANSFIELD, D.J.

In this action brought pursuant to 26 U.S.C. §7422 and 28 U.S.C. §1346(a) for the refund of taxes paid during the taxable years 1953 and 1954, defendant United States has moved for summary judgment. Plaintiff counters that there are fundamental unresolved issues of fact requiring denial of the motion, and argues in the alternative that if summary judgment is to be granted, it must be granted in plaintiff's favor. For reasons discussed in detail below, we deny both motions but conclude pursuant to Rule 56(c) and (d) that no genuine issues exist as to plaintiff's claim except as indicated.

The action arises out of plaintiff's issuance in 1947 of $115,246,950 in 3% thirty-year sinking fund debentures in exchange for its then outstanding preferred and preference stock. Plaintiff contends that the debentures were issued for a consideration amounting to less than their face value. More specifically it claims that its preferred and preference shares received in exchange were worth substantially less than the face amount of the debentures.

In 1953 and 1954 plaintiff repurchased certain of the debentures. It contends that these purchases resulted in losses to it which were deductible pursuant to §165(a) of the Internal Revenue Code.[1] Furthermore, on the theory that the debentures

were issued at a discount in 1947 it claims the right to deduct annually an amortized percentage of the discount over the life of the debentures pursuant to Internal Revenue Regulation §1.61-12 the relevant portion of which provides:

> "... If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. If the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year...."[2]

Defendant contends that the consideration received by plaintiff upon issuance of the debentures was exactly equal to their face amount, and that since defendant received "equal for equal" no loss was sustained. Furthermore, defendant argues that even if there was a differential between the face amount of the debentures and the consideration received, it would not amount to a deductible "discount" within the meaning of the above-quoted regulation.

Background

In late January, 1941, plaintiff Cities Service became a registered holding company under the Public Utility Holding Company Act of 1935, thereby subjecting itself to special regulation by the Securities and Exchange Commission. Pursuant

to that Act and to various orders issued by the SEC, Cities Service was required to divest itself of certain of its public utility interests and to undertake a simplification of its corporate and capital structures.

Accordingly, on November 20, 1946, Cities Service presented a "Plan pursuant to Section 11(e) of Public Utility Holding Company Act of 1935 for simplification of corporate structure" to its shareholders and to the SEC. At the time of the submission of this original plan Cities Service had outstanding, in addition to slightly over 100 million dollars in debentures and about 37 million dollars par value of common stock, three classes of no par voting cumulative preferred and preference stock whose stated value aggregated about 58.7 million dollars. The dividends on these three classes of preferred stock had been passed for 14 years, and the arrearages totalled approximately 49.7 million dollars. The plan submitted provided for prompt cash redemption of the outstanding debentures, and for the exchange of the preferred and preference stocks for an issue of 3% fifty-year sinking fund debentures in an amount equal to the stated value of the preferred and preference shares plus accumulated and unpaid dividends, or approximately 108.4 million dollars. The plan further provided that approval of the exchange by the holders of 60% of the preferred shares would be required before the plan would become effective.

Beginning in December, 1946, and continuing for some months thereafter, the SEC conducted hearings on the fairness of the plan. On the opening day of the hearings objections to the plan were raised by various preferred shareholders. They pointed out that while debenture holders, upon retirement of their securities, were being given their full call price in cash, the preferreds were to receive only the liquidation value of their shares, and even that in the form of securities which could not be expected to sell at par under prevailing market conditions. Cities Service's earnings, they argued, had long been and would continue to be sufficient to pay dividends on the preferred if the management would only forego its established policy of using all surplus earnings to retire debt. Under the circumstances, they contended, Cities Service should pay the full call price of the preferred shares as well as that of the outstanding debentures to be retired. It was also suggested that the interest rate on the debentures to be issued in exchange for the preferred stock be raised to 3 1/2%, presumably to increase the chances that the debentures could be sold at par.

On February 14, 1947, after extensive testimony by Cities Service executives, engineers and investment bankers as to the fairness of the proposed plan, and shortly before a preferred shareholders' committee was to proceed with its opposing

proof, Cities Service amended its plan to meet the objections of the preferred shareholders. The amended plan reduced the maturity of the 3% debentures from fifty to thirty years, awarded the preferred stockholders debentures in a principal amount equal to the call premium on their shares plus their stated value and dividend arrearages, dispensed with the necessity of stockholder approval of the exchange, and restricted the rights of Cities Service to declare common stock dividends and to incur new debt during the life of the debenture issue.

The preferred shareholders thereupon withdrew their objections to the amended plan. On April 24, 1947, the amended plan was approved by the SEC. Three days later the United States District Court for the District of Delaware signed an order enforcing the plan, which thus became effective on May 27, 1947.

At the time the plan became effective, Cities Service had outstanding three separate classes of preferred and preference stock: (1) preferred stock, (2) preference B stock, and (3) preference BB stock.

The preferred class consisted of 560,600 shares of $6.00 cumulative preferred stock carrying an annual dividend of $6.00 and callable at plaintiff's option at any time at a price of $112.00 per share ($100.00 stated value plus $12.00 call premium) plus accumulated and unpaid dividends. As of May 27,

1947, each share of preferred was carrying $84.50 in accumulated and unpaid dividends. The redemption price for each share of preferred was thus $196.50 and the total redemption price for the 560,600 shares outstanding was $110,157,900.

The preference B class consisted of 86,000 shares of 60¢ cumulative no par stock carrying an annual dividend of 60¢ and callable at plaintiff's option at a price of $10.60 ($10.00 stated value plus 60¢ call premium) plus accumulated and unpaid dividends. As of May 27, 1947, each share of preference B stock was carrying $8.75 in accumulated but unpaid dividends. The redemption price for each share of preference B was thus $19.35 and the total redemption price for the 86,000 shares outstanding was $1,664,100.

The preference BB class consisted of 17,700 shares of $6.00 cumulative no par shares carrying an annual dividend of $6.00 and callable at plaintiff's option at a price of $106.00 ($100.00 stated value plus $6.00 call premium) plus accumulated and unpaid dividends. As of May 27, 1947, each share of preference BB stock was carrying $87.50 in accumulated and unpaid dividends. The redemption price for each share of preference BB was thus $193.50 and the total redemption price for the 17,700 shares outstanding was $3,424,950.

On May 28, 1947, plaintiff issued its thirty-year 3% sinking fund debentures in the aggregate amount of $115,246,950

in exchange for all its outstanding preferred, preference B and preference BB shares, all rights appertaining thereto, and all dividend arrearages thereon. Each share of each class thus received precisely its call price in face amount of the new debentures in the exchange. By the terms of the indenture plaintiff was required to retire at least $1,500,000 in principal amount of debentures annually. Accordingly, during the taxable year 1953 it repurchased $1,519,500.00 face amount of debentures at an aggregate cost of $1,398,357.39, and during the taxable year 1954 purchased $1,805,900.00 face amount of debentures at an aggregate cost of $1,786,569.02.

Two other figures whose relevance will become apparent further on in this discussion are worthy of mention. Plaintiff Cities Service contends, and for purposes of this motion the United States is willing to concede, that the three classes of preferred and preference shares under discussion were originally issued by the plaintiff at various times in consideration for cash and properties having an aggregate fair market value at the time of issuance of no more than $45,323,846.00. Similarly the plaintiff contends, and defendant provisionally concedes for purposes of its motion, that at the time of the exchange in 1947 the aggregate fair market value of the preferred and preference shares was $86,313,600.00.

Plaintiff's Theories of Recovery

Plaintiff advances two theories in support of its claim to a tax deduction arising from its repurchase of debentures in 1953 and 1954. Both theories are based on plaintiff's contention that it paid more to redeem the debentures than it received in exchange for them upon issuance in 1947. What it received -- the issue price of the debentures -- plaintiff contends, was either the fair market value of the preferred and preference shares surrendered upon the 1947 exchange ($86,313,600.00), or the fair market value of the cash and properties originally paid in upon issuance of those shares in prior years ($45,323,846.00). The first theory holds simply that a deductible loss was realized upon repurchase of debentures at a price higher than the price realized upon their issuance. The second theory, based on Reg. §1.61-12, holds that the issuance of the debentures at less than face in 1947 gave rise to bond "discount" within the meaning of that Regulation, entitling plaintiff to prorate or amortize the discount over the life of the bonds and to deduct both the amortization thereof for the taxable years in question and the unamortized portion of the discount attributable to the debentures retired in those years. Each theory produces two figures for the proposed deduction, depending on which of the two measures of the issue price of the debentures in 1947 is employed. See Complaint ¶¶35-39, 44-48.

Defendant's answer to both theories is the same: the debentures were in fact issued at face value. Hence no discount arose from the exchange, and since the consideration received for the debentures equalled their face value, no loss was sustained when plaintiff repurchased them at less than face in 1953 and 1954. Defendant also contends that even if the debentures were issued at less than face, the differential is not deductible discount.

Discussion

Three distinct questions are presented on this motion. First: Was the consideration received by Cities Service in exchange for the debentures issued in 1947 less than the face or principal amount of the debentures? Second: If so, does the difference give rise to a deductible loss or, in the alternative, to an amortizable discount within the purview of Reg. §1.61-12? Third: How is the difference, if any, to be measured?

Was the Consideration Received Less than the Face Amount of the Debentures?

At the outset we are confronted with the fact that the face amount of the debentures issued in 1947 -- $115,246,950 -- was identical with the cash amount that plaintiff would have been required to pay to the preference and preferred shareholders if it had chosen to redeem their shares. If it had redeemed the shares, the aggregate amounts paid out in cash would have been as follows:

Stated value	$ 58,690,000
Accrued undeclared cumulative dividends	49,671,950
Redemption premium	6,885,000
Redemption call price	$115,246,950

Seizing upon this identity of figures defendant contends that what really happened during the course of the hearings before the SEC was that plaintiff redeemed the preferred and preference shares, paying the full call price for them, albeit in the form of debentures rather than cash. According to defendant the issuance of the debentures and plaintiff's receipt of stock constituted the cancellation of concrete obligations totalling $115,246,950, and plaintiff's only real alternative would have been to issue debentures on the market and then redeem the preferred and preference shares by paying the full call price in cash to their holders. Instead plaintiff chose, in defendant's view, to pay off the shareholders in debt paper.

There are fatal flaws in defendant's position. In the first place, debentures are frequently not worth their face value in cash, particularly where the interest yield (here only 3%) compares unfavorably with the current market, in which event they can only be issued for a consideration less than their face value. Indeed plaintiff has offered abundant proof that here the actual value of the shares received in exchange for the debentures was

substantially less than the redemption call price, and defendant has offered no contrary proof. For instance, the aggregate closing market price of the shares on the day before the exchange was $104,827,450. An expert appraisal of the shares, adjusted to eliminate the effects of the impending exchange, concludes that their inherent fair market value on May 27, 1947, was $86,313,600. Moreover, plaintiff, upon original issuance of the shares, received an aggregate of only $45,323,846 as against the much higher redemption call price. Lastly, between the time when the amended plan was proposed (after which investors could and would value the Cities Service preferred and preference stocks with reference to the securities for which they were soon to be exchanged) and the date of the exchange, plaintiff's preferred shares never sold at more than 91% of the face amount of the debentures they represented. On the date of their issue, furthermore, the debentures closed at 91 7/8, their high for the day, and did not get above 93 for over two months. Thus all proof before us indicates that the shares were worth less than the face amount of the debentures issued.

Secondly, it is clear that the 1947 exchange did not constitute a redemption. Under the terms of plaintiff's charter a redemption would occur only if plaintiff voluntarily and unilaterally retired its shares by payment of the agreed-upon

redemption call price in cash to the shareholders, in which event the latter had no alternative but to accept the cash redemption call price. (Def's Ex. D, Section Fourth, ¶7). No cash was paid. Instead, plaintiff, with the SEC's approval, exchanged debentures which according to their terms would not be redeemable in cash for thirty years. The preferred and preference shareholders' rights upon liquidation did not mature by reason of the operation of Section 11 of the Public Utility Holding Act.[3] Furthermore, it was not necessary for the provisions of the charter to be followed in a plan of simplification pursuant to Section 11 of the Public Utility Holding Company Act. In re Electric Bond & Share Co., 73 F. Supp. 426, 446 (S.D.N.Y. 1946). The SEC had the power to authorize plaintiff, in its simplification of its financial structure pursuant to the SEC's order, to adopt a plan for retirement of the preferred and preference shares which would not amount to a redemption. In re Electric Bond & Share Co., supra. For instance, the SEC could even have authorized plaintiff to make a cash purchase of the outstanding shares in the open market at less than the redemption call price.[4]

In fact the amended plan did not conform to the specific redemption provision of plaintiff's charter. As the SEC observed in its Findings and Opinion on the plan, retirement of securities pursuant to a plan of simplification under Section

of the Public Utility Holding Company Act is not voluntary. Furthermore the shareholders were not required at plaintiff's option to accept the plan, as would have been the case if their shares had been redeemed for cash pursuant to the charter. Since plaintiff offered debentures rather than cash, the stockholders exercised their right to oppose the plan and in fact the plan was consummated only after hard bargaining and a modification of the original offer resulted in their withdrawing their initial objections.

This view of the transaction was confirmed by the SEC which, in its Findings and Opinion on the amended plan of simplification, concluded that Cities Service's financial structure made it "extremely unlikely that Cities could presently undertake to redeem or refinance its preferred stock."[5] Furthermore the SEC stated plainly that the equivalence of call price and face amount of the debentures issued should not be interpreted to mean that a redemption had taken place:

> "It is well established that in measuring the claims which preferred stockholders surrender in a Section 11(e) plan such as this, their rights in liquidation are not considered to have matured by operation of Section 11; and consideration must be given to all of the rights and limitations attaching to the preferred stocks, with primary emphasis upon immediately operative rights such as rights in respect of earnings and dividends as against inchoate rights such as rights in liquidation. [Citations omitted]" (Def's Ex. C at 22).

Finally, in a footnote to its observation that if the new debentures should be called in the future the then holders would at that time receive an amount equal to the redemption call price of the shares, the Commission stated:

> "This result does not mean that we consider that the claims of the preferred and preference stockholders are being retired at their respective call prices, nor that they are entitled as a matter of law to the call price as such. It is well established that a retirement of senior securities pursuant to the impact of Section 11 is not a voluntary retirement so as to bring into play the redemption provisions of the charter or indenture. [Citations omitted]" (Def's Ex. G at 25 n.35).

Nor did the SEC's determination that the plan was fair and equitable to all parties and that the debentures were the "equitable equivalent" of the rights surrendered imply that the debentures were worth their face value at the time of issuance. It merely meant that their discounted value was approximately equal to the value of the properties received in exchange. This was later recognized by the district court in discussing the argument that under the amended plan the redemption premium was being paid:

> "The argument that the premium is being paid must be based on the assumption that these 3% debentures are the equivalent of money. This is an assumption which I refuse to make. Even conceding that the debentures are superior in quality to the old preferred stock, it is still not certain that they are of grade to sell on a

> money basis and even if they were, what the rate would have to be to support a price of 100." (In re Cities Service Company, 71 F. Supp. 1003, 1005 (D. Del. 1947))

Thus the district court anticipated Judge (now Justice) Marshall's later observation in Nassau Lens Co. v. Commissioner, 308 F.2d 39 (2d Cir. 1962), that "surely a promise today to pay $150,000 in ten years is not presently worth $150,000 either in property or cash." (308 F.2d at 44).

Admittedly the decision to issue debentures in an aggregate face amount equal to the redemption call price of the preferred shares presented a superficial identity that lends support to defendant's position. The history of the parties' negotiations and of the proceedings before the SEC, however, confirm that the identity in face amounts represented nothing more than a plausible trading objective used by shareholders who objected to the original plan. Since holders of the existing 5% Convertible Debentures were under the plan to be paid the full call price of their bonds in cash, it was natural for the preferred shareholders to demand debentures equal to the call price of their shares. However, it was anticipated that the 3% debentures to be issued would probably be worth, in current market terms, significantly less than their face value. Apparently recognizing this the shareholders also sought an increased interest rate on the new debentures and more favorable

terms in the indenture. See Def's Ex. E at 7-8, 12, 1144-45. The totality of these circumstances robs defendant's contention (that the exchange amounted to a redemption) of its force.

In further support of its contention defendant points to the fact that the plan as originally proposed contained a condition that 60% of the affected shareholders must approve the exchange before it could become effective, and that this condition was later deleted, thus making it possible to effectuate the change without shareholders' approval, just as a redemption could be carried out under the terms of the corporate charter. (Def's Main Brief at 6; Def's Ex. D Section "Fourth" Par. 7). The simple answer is that shareholder approval was not required for consummation of any exchange authorized by the SEC, including the exchange contemplated in the original plan. Furthermore, plaintiff's president in his testimony before the SEC Hearing Examiner explained that the original provision requiring shareholder approval was motivated by management's feeling that it had an obligation not to try to push the plan through without shareholder backing. (Def's Ex. E at 51). Removal of the provision was largely a response to shareholders' objections to expenditures for solicitation of stockholders' assents. (See Def's Ex. E at 13, 1122-23, 1144).

In conclusion we view the 1947 issuance of debentures

as an exchange and not a redemption.[6] It was a transaction whereby shareholders (whose dividends and preferential rights had long been "of little practical moment to them"[7]) became creditors owning long term debentures instead of stock. However one chooses to measure the consideration they gave up, there is every indication that it was substantially less than the face amount of the debentures they received.

Is the Difference Deductible?

If plaintiff had in 1947 issued its debentures for cash amounting to less than the face amount of the debentures, it would, upon redeeming some of the debentures, have been entitled to deduct the excess paid out over the cash received as a loss under §165(a) of the 1954 Code and treat the entire difference as an amortizable discount under Reg. §1.61-12(c). Helvering v. Union Pacific R.R., 293 U.S. 282 (1934). Defendant further concedes that if plaintiff "had issued bonds at a discount and realized a net amount sufficient to purchase the securities in the market the difference between the face amount of the debentures and the realization would have been properly treated as discount" (Def's Memorandum at 31).

Similarly if plaintiff had issued the debentures in exchange for property worth less than the face amount of the debentures, it is settled in this Circuit that the difference

could be treated in the same fashion. Nassau Lens Co. v. Commissioner, 308 F.2d 39 (2d Cir. 1962) (Marshall, C.J.); American Smelting & Refining Co. v. United States, 130 F.2d 883 (3d Cir. 1942). The difference between the face amount of the bonds issued for property and the market value of the property acquired is treated as discount for the reason that it represents the cost of the money that would otherwise have to be borrowed in order to make a cash purchase of the property received in exchange. Nassau Lens Co. v. Commissioner, supra.

Defendant argues strenuously that in addition to establishing that the property acquired is worth less than the face amount of bonds issued for it, the taxpayer cannot treat the difference as a discount unless it also sustains the burden of proving that the difference is traceable to market demand for a higher effective interest rate than the stated yield of the bonds. While nothing in Reg. §1.61-12(c) either requires or implies such a limitation, there is unquestionably judicial support for the proposition. See, e.g., San Joaquin Light & Power Corp. v. McLaughlin, 65 F.2d 677 (9th Cir. 1933); Dodge Brothers v. United States, 118 F.2d 95 (4th Cir. 1941); American Smelting & Refining Co. v. United States, 130 F.2d 883 (3d Cir. 1942); Montana Power Co. v. United States, 232 F.2d 541 (3d Cir. 1956) (dictum); Atchison, Topeka & Santa Fe Ry. v. United States, 69-2 U.S.T.C.

¶9740 (D.C. Kans. 1969) (semble). There is also support for the contrary proposition. See, e.g., Baltimore Steam Packet Co. v. United States, 180 F. Supp. 347 (Ct. Cl. 1960); Roberts & Porter, Inc. v. Commissioner, 307 F.2d 745 (7th Cir. 1962); Universal Tractor-Equipment Corp. v. United States, 67-1 U.S.T.C. ¶9409 (E.D. Va. 1967); Missouri Pacific R.R. v. United States, Nos. 142-67 & 95-68 (Ct. Cl. June 12, 1970). See also Fashion Park, Inc. v. Commissioner, 21 T.C. 600 (1954) (where, however, the Commissioner apparently conceded the point at issue here, and the discussion concerns income rather than loss deductions).

Without attempting a detailed analysis of the above-cited decisions or suggesting that a crystallized rule can be distilled from them as to precisely when a difference in consideration may or may not be treated as a discount, we are convinced that the conflict between the decisions is more apparent than real. The general conclusion that we draw is that where a true loss has been sustained by the taxpayer's issuance of obligations payable at their face value at some future date, the debt-discount concept, which is at best a more or less arbitrary creation, will not be construed in a technical manner to bar the taxpayer from deducting the loss as discount. In short the difference between the face amount of a bond (which the issuer agrees to pay upon maturity) and the lesser

consideration received upon its issuance "is normally considered" a discount in the absence of circumstances indicating that the difference was not intended as a discount. See Erie Lackawanna R.R. v. United States, 422 F.2d 425, 427-28 (Ct. Cl. 1970).

In this case we face an additional problem in that the property acquired by plaintiff in exchange for issuance of its debentures consisted of plaintiff's own preferred shares and the hope of the holders of such shares that the plaintiff might at some future time pay them the amount of the accrued but undeclared and unpaid cumulative dividends.[8] This raises the question of whether such a reduction or change in a taxpayer's own capital structure may be treated as giving rise to loss or discount. Where obligations are issued for cash or other property in an amount less than face, the existence of a loss or discount is readily ascertainable by reference to the fair market value of the property acquired. Where a taxpayer, however, acquires at a discount (in exchange for new bonds or debentures) obligations for which it received consideration equal to the full face amount upon original issuance, it is in effect issuing a new discounted obligation in place of an old one. No loss has been suffered by the taxpayer because at one time it has received the full face amount of the originally issued obligation. For this reason a deduction of the difference between the fair market value of the

outstanding obligations and the face amount of the new ones has sometimes been denied. Missouri Pacific R.R. v. United States, Nos. 142-67 & 95-68 (Ct. Cl. June 12, 1970); Erie Lackawanna R.R. v. United States, 422 F.2d 425 (Ct. Cl. 1970). Such a transaction is treated as an "exchange of equals" in which "The corporation has not obligated itself to pay out any more than it has received." Missouri Pacific R.R. v. United States, supra, Slip Op. at 5. Therefore the face value of the old obligations "at the time of their issuance is the true valuation of the securities as far as plaintiff is concerned." (Id. at 6; emphasis in original). Thus even though the fair market value of the taxpayer's own obligations may be less than the face amount of the new debentures being used to retire them, the difference will not be treated as a deductible loss or discount if the plaintiff originally received consideration equal to the face amount of the obligations being replaced.

Even assuming the applicability of the above principles to the present case, however, the record discloses the existence of deductible discount. The preferred and preference shares were originally issued in exchange for cash and property amounting to $45,323,846. Even if there is added to this figure the sum of $49,671,950 for accrued undeclared cumulative dividends,[9] the resulting total of $94,995,796 is substantially below the face amount of the debentures issued, i.e., $115,246,950.

Defendant nevertheless argues that plaintiff should not be permitted to deduct any part of the difference between face amount of the debentures, on the one hand, and any lesser value attributed to the preferred and preference shares received on the other, for the reason that the result would be to allow non-deductible expenditures to be converted into deductible ones by the simple expedient of issuing debt obligations instead of paying cash. Under defendant's view, by issuing debentures plaintiff extinguished matured obligations in satisfaction of which it would otherwise have paid cash, in which case it could not have derived any deductions from the transaction. Plaintiff's position is that the debentures were merely a substitute for cash, and that the debentures-for-stock arrangement, as the equivalent of a cash version of the same transaction, should entail similar tax consequences.

The fallacy in defendant's approach, however, lies in its assumption that the 1947 transaction was a redemption in which plaintiff was using debentures instead of cash to redeem matured obligations that would total $115,246,950 if a cash redemption had been worked. As we have already pointed out, however, the exchange was not a redemption and the cash payment analogy therefore loses its force. Since the transaction amounted to a conversion of preferred stock and hopes for eventual pay-

of accrued accumulated dividends into creditors' claims, there is no reason to treat the issuance of debentures as a direct payoff of each of the elements of the call price that would be payable if there had been a redemption. In short if cash had been paid pursuant to the redemption provisions of the charter, there would not have been any deductible discount. But cash was not paid, and there was no redemption. Debentures were issued at a face value in excess of the consideration received for them, giving rise to deductible discount.

At the time when the preferred and preference shares were originally issued, Cities Service received certain cash and properties and assumed certain conditional obligations, i.e. (1) not to pay any dividends out of earnings or surplus to common stockholders as long as there were accrued but unpaid cumulative dividends on the preferred; (2) to pay stated value plus accrued and unpaid dividends to preferred shareholders upon any liquidation, dissolution or winding up, whether voluntary or involuntary, before any payment to the common stock; and (3) to pay the stated call price, including premium, plus unpaid dividends, to preferred stockholders upon any call for redemption. By 1947, 14 years of dividends on the preferred shares had been passed, precluding any dividends from being paid to the common until the accrued cumulative dividends were declared and paid.

However, plaintiff was not obligated to purchase its own ownership (i.e., its preferred and preference shares) and its obligation to pay dividends to such holders was at most contingent on the existence of earnings and whether the management in good faith determined that the earnings should not be used for more essential corporate purposes. Certainly plaintiff had the absolute right not to redeem its preferred and preference shares.

The effect of the 1947 exchange was a radical change in plaintiff's debt obligations. In lieu of a conditional obligation to pay dividends on the preferred and preference shares, depending upon earnings and the management's good faith exercise of its discretionary powers, plaintiff now became firmly and unconditionally obligated to pay the face amount of the new debentures plus 3% interest annually on the unpaid balance. Even assuming arguendo a prior obligation to pay dividend arrearages, the maximum amount of the accrued dividends was $49,671,950, as against debentures in the face amount of $115,246,950. Viewed in this light, plaintiff indeed suffered a loss when in 1953 and 1954 it paid more to retire certain of the debentures than it had received for them. It is also clear that to allow plaintiff to deduct this loss is not to allow it to convert non-deductible expenditures into deductible expenditures by the simple expedient of paying in bonds rather than in cash. The "expedient" in question, if it can be so called, involved far more than the

substitution of currencies urged by the defendant. It involved the assumption of enlarged and unconditional obligations by the plaintiff, as a result of which deductible losses have been realized.

How is the Loss or Discount to be Determined?

Reduced to simplest terms the deductible loss or discount is the "difference between what is given up and what is received" by the taxpayer. Missouri Pacific R.R. v. United States, Nos. 142-67 & 95-68 (Ct. Cl. 1970) Slip Op. at 10. In calculating that difference in the present case no disagreement exists as to the face amount of the new debentures or the amounts paid by plaintiff to repurchase some of them. It is equally clear that for present purposes the minimum amount which plaintiff may ascribe to the preference and preferred shares acquired by it is the original consideration received when the shares were issued, i.e., $45,323,846.[10] Furthermore, for the reasons we have already indicated, even if the market value of the shares at the time of the exchange had declined below their original issue price, plaintiff would be precluded from claiming the decline in value as a loss because, having received the cost price upon issuance of the shares, it had not actually suffered a loss to the extent of the market decline. Erie Lackawanna R.R. v. United States, 422 F.2d 425 (Ct. Cl. 1970).

Thus the original cost of the preferred and preference shares represents a floor, or minimum value, for determining plaintiff's loss or discount. Relying principally upon the Court of Claims' recent decisions in Erie Lackawanna and Missouri Pacific, supra, plaintiff contends that the original issue or cost price of the shares should also represent the ceiling. With this we disagree.

Although a taxpayer, upon issuance of bonds in exchange for its shares, may not claim a loss based upon a decline in the market price of the shares below the price realized by it upon their original issuance, Erie Lackawanna, supra; Missouri Pacific, supra, it does not follow that the shares or obligations cannot turn out to have a greater value to the taxpayer than their original issue price. In the present case, for instance, even though the accrued and unpaid accumulated dividends did not constitute a firm obligation for which the plaintiff had received any consideration, the preferred and preference shareholders could use the dividend provisions of the charter to preclude plaintiff's management from paying any dividends on the common and to restrict the uses to which plaintiff's earnings could be put. Furthermore, it is possible that circumstances might arise where they could force the management to declare and pay part or all of the accrued dividends.[11]

Thus, where a taxpayer receives its own shares in exchange for issuance of its debentures, the value of "what is received" for purposes of determining the deductible loss or discount may be higher (though not lower) than the original issue price of the shares. The actual value to the taxpayer can be determined only after consideration of all relevant data, including the market value of the shares, the financial condition of the taxpayer at the time of the exchange, its profits prospects, and expert opinion. Although the market price would be relevant, especially since it might reflect the public's opinion as to shareholders' prospects for participating in future corporate distributions, it would not be conclusive. Furthermore, market prices for the period immediately prior to the exchange might in the present case be discountable for the reason that from the date when the details of the amended plan became public investors may have assessed the shares in terms of the debentures for which they would soon be exchanged. The market price of the shares may also be vulnerable on the ground that it represented trading in a limited number of shares, whereas the exchange was concerned with the retirement of the entire issue of preferred and preference stock. Nevertheless we believe that after consideration of such relevant factors as may be offered, including market price, it should be possible to arrive at a figure

representing the value to plaintiff of the shares in question. See, e.g., Atcheson, Topeka & Santa Fe R.R. v. United States, 69-2 U.S.T.C. ¶9740 (D. Kans. 1969).

Affirmative Defenses

In its answer defendant contends that this court is without jurisdiction of certain of plaintiff's refund claims under 26 U.S.C. §7422[12] because of plaintiff's failure to file such claims with the Internal Revenue Service before instituting suit. More specifically, defendant urges that plaintiff has never filed (1) a loss-based claim for the taxable year 1953 under any measure of value; (2) a loss-based claim for the year 1954 on the original consideration measure; (3) a discount-based claim for either year for the unamortized portion of the discount attributable to debentures retired in those years; (4) a discount-based claim for either year under either the original consideration or adjusted market value measures of value. It is not contested that plaintiff did file discount-based refund claims for both years under a market price measure of value, or that the 1954 claim was later amended to add a loss-based claim employing the original consideration measure of value.

While refund claimants are not entitled to rely at the trial stage upon theories of law or versions of the facts which they did not assert in their original claims for refunds, Pelham

Hall Co. v. Carney, 111 F.2d 944 (1st Cir. 1940); Memorial Corporation v. United States, 188 F.2d 745, 750 (3d Cir.), cert. denied, 342 U.S. 834 (1951); 10 Mertens, Law of Federal Income Taxation §58.17, not every variation between the original claim and the complaint in a civil suit thereon is fatal to recovery. As this Circuit has stated:

> "We think that [the 1939 Code's equivalent of §7422] go[es] no further than to require the taxpayer to set forth facts sufficient to enable the Commissioner of Internal Revenue to make an intelligent administrative review of the claim."

Scovill Manufacturing Co. v. Fitzpatrick, 215 F.2d 567, 569 (2d Cir. 1954). See also 10 Mertens, Law of Federal Income Taxation §58.21.

We think that the instant case comes well within the immaterial variance category. Without reaching the question of whether plaintiff's original refund claims could be held sufficient to support every one of its theories and proposed measures of recovery in this suit, it is clear that its discount-based claims under a market price measure of the value of the preferred and preference shares received were more than adequate to apprise defendant of both the theory and measure of recovery on which we have proceeded in this opinion.

Conclusion

Although defendant has accepted plaintiff's calculation

as to the original issue and adjusted market prices of the preferred and preference shares for purposes of our ruling on its motion for summary judgment, it has expressly reserved the right, in opposing plaintiff's similar motion, to challenge these figures and to exercise its rights under Rule 56(f), F.R.C.P., to cross-examine or depose the experts upon whom plaintiff relies. Upon plaintiff's motion for summary judgment an issue of fact is therefore raised as to the amount of the dollar value to plaintiff of the preferred and preference shares surrendered in exchange for defendant's issuance of its debentures in 1947.

Plaintiff's motion for summary judgment is therefore denied. Pursuant to Rules 56(c), (d), however, we conclude that the sole material fact actually controverted is the value to plaintiff of the preferred and preference shares received by it upon issuance of its debentures and that no genuine issue is presented as to all other material facts, which shall be deemed established. Accordingly a trial will be conducted as to the remaining issue, and once the value of the shares received has thus been determined, any refunds due plaintiff will be determined by simple mathematical computation.

Defendant's motion is denied in all respects.

Settle order on notice.

Dated: July 23, 1970.

U.S.D.J.

FOOTNOTES

1. "General Rule.--There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise."

2. Regulation §1.61-12 is, in all pertinent respects, substantially identical to its predecessor under the 1939 Code.

3. In re New England Public Service Co., 73 F. Supp. 452, 45[illegible] (D. Me. 1947); In re United Light & Power Co., 22 S.E.C. 704, 715-17 (1946).

4. SEC Reg. §250.42 (CCH Fed. Sec. L. Rep., Vol. 3, ¶37,522), adopted in Release No. 35-6, Oct. 9, 1935, and amended in Release No. 35-6318, Dec. 27, 1945 (10 F.R. 15412), provides that

> "No registered holding company or subsidiary thereof shall acquire, retire or redeem any security of which it is the issuer (or which it has assumed or guaranteed) except pursuant to a declaration notifying the Commission of the proposed transaction, which has become effective in accordance with the procedure specified in §250.23 [¶36,655], and pursuant to the order of the Commission with respect to such declaration under the applicable provisions of the Act."

Certain exceptions and provisos follow, none of which are applicable to the transaction before us. The "procedure specified in §250.23" is purely technical, and presents no obstacle to SEC approval of a cash deal with preferred shareholders.

5. Def's Ex. G at p.24.

6. Although the terms used in the amended plan would not be controlling, it is significant that the parties and the SEC described the issuance of debentures as an "exchange," as distinguished from the retirement of the 5% Convertible Debentures, which was properly described as a "redemption," or call and cash payment in accordance with their terms. (Def's Ex. G, p.7).

7. Def's Ex. G at p.23.

8. A cumulative dividend provision merely bars the management from paying dividends on common stock until the accumulated dividends are paid to the preferred. It does not, however, constitute the preferred stockholder a creditor or claimant for the accumulated undeclared dividends, unless the dividends have been withheld in bad faith. 11 W. Fletcher, Cyclopedia of Corporations ¶5325; 12 id. ¶5451 and cases there cited.

9. See note 8, supra.

10. It should be noted that the defendant has reserved the right to contest this figure. See page 31, infra.

11. See note 8, supra.

12. Section 7422(a) provides as follows:

> "No Suit prior to Filing Claim for Refund.--No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof."

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

CITIES SERVICE COMPANY,

Plaintiff,

-against-

UNITED STATES OF AMERICA,

Defendant

ORDER

67 Civ 4606

Plaintiff and Defendant having each moved for summary judgment pursuant to F.R. Civ. P. 56 and both motions having come to be heard and the Court having issued its opinion on July 21, 1970 disposing of both motions,

Now in accord with that opinion,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that defendant's motion for summary judgment is denied; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that plaintiff's motion for summary judgment is denied, and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this case be set down for trial in due course with the sole factual question to be resolved thereat being the value to plaintiff of the preferred and preference shares received by it in exchange for the issuance of its 3¼ Thirty Year Sinking Fund Debentures (the bonds) on May 27, 1947; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, pursuant to F.R. Civ. P. 54(d) the bonds shall be deemed issued at a price equal to the value to plaintiff of the preferred and preference shares received in exchange for their issuance on May 27, 1947; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, pursuant to F.R. Civ. P. 56(d), the value of those shares to plaintiff shall be no less than $45,323,846, the value of the consideration originally received for their issuance; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, upon resolution of said sole remaining factual issue between the parties, the amount of any deductible loss or discount will be determined by mathematical calculation.

Dated: New York, New York
October 10, 1975

WALTER P. MANSFIELD
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- x

CITIES SERVICE COMPANY,

Plaintiff,

-against- 67 Civ. 4606

UNITED STATES OF AMERICA,

Defendant.

- x

APPEARANCES:

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Attorney for the United States of America

BRIAN J. CALLAGHER, ESQ.
Assistant United States Attorney
Of Counsel

WYATT, District Judge,

This is a second motion by defendant for a summary judgment in its favor. Fed. R. Civ. P. 56 The motion must be denied.

The action is for refund of income taxes paid by plaintiff for the two years ending respectively on December 31, 1953 and December 31, 1954. 26 U.S.C. § 7422. Jurisdiction is asserted, and appears to exist, under 28 U.S.C. § 1346(a)(1).

Plaintiff in 1947 issued thirty year 3% debentures in exchange for shares of its own $6 preferred stock, $6 preference BB stock, and 60¢ preference B stock. By the terms of the indenture, plaintiff was required to retire annually $1,500,000 principal amount of debentures.

In 1953 and in 1954, plaintiff purchased in the open market, and retired, in excess of $1,500,000 principal amount of debentures.

Plaintiff asserts that when the debentures were issued in 1947 it received less in value for them than their face (principal) amount.

Starting from this assertion, plaintiff then has two alternative theories to support the present claim for income tax refund:

> first, that plaintiff paid more in the open market for the debentures retired in 1953 and 1954 than plaintiff had received for them on issuance in 1947 and that this difference is a "loss" deductible under 26 U.S.C. § 165(a); or
>
> second, that the debentures were issued in 1947 at a discount, the amount of which is deductible, prorated over the 30 year life of the debentures, under Treas. Reg. § 1.61-12(c)(3).

Defendant moved for summary judgment and the matter was heard by Judge Mansfield on February 10, 1970.

On July 24, 1970, Judge Mansfield filed a careful opinion, since reported at 316 F.Supp. 61. This opinion sets out the factual and legal background, which will not be repeated here.

The motion of defendant for summary judgment was in all respects denied.

Judge Mansfield further found that plaintiff was entitled to summary judgment as to all issues of law and as to all issues of material fact, except one: "the value to plaintiff of the preferred and preference shares received by it upon issuance of its debentures". 316 F.Supp. at 74.

An order was directed to be settled on notice.

It appears that defendant submitted a proposed order on October 16, 1970 containing a statement under 28 U.S.C. § 1292(b) to permit an interlocutory appeal; that plaintiff submitted a counter order on October 20, 1970; that defendant wrote to Judge Mansfield on November 30, 1970 advising him that defendant would make a second motion for summary judgment, stating that it seemed to be appropriate "to delay any certification of issues for appeal until this motion is decided", and expressing the hope that Judge Mansfield would accept a reference of the second motion for summary judgment.

Defendant then made the present (second) motion for summary judgment. The Reply Memorandum for defendant (page 11) contains this sentence:

> "On December 18, 1970, the defendant was advised that Judge Mansfield would be unable to accept a reference of the motion."

This second motion for summary judgment by defendant then came on to be heard by me in the civil motion part on February 9, 1971.

On February 11, 1971, Judge Mansfield filed an order on his decision. The form of order was that submitted by plaintiff. There was no statement to permit an interlocutory appeal under 28 U.S.C. § 1292(b).

This second motion of defendant for summary judgment is in actuality a motion to reargue the motion denied by Judge Mansfield. The procedure followed by the government is of doubtful propriety, to say the least. I decline to examine the merits of the decision of Judge Mansfield. I accept that decision as the law of the case in this Court. If the decision be wrong - and by no means do I suggest that it is wrong - in the fullness of time the government may secure a correction in the Court of Appeals.

The excuse of the government for this second motion for summary judgment is that on November 13, 1970 the Court of Claims handed down a second decision (on a motion for rehearing) in Missouri Pacific R.R. v. United States, 433 F.2d 1324. According to the government, under this decision "the value to plaintiff of the preferred and preference stocks it received in exchange for its bonds was no less than the maturity value of these bonds" (Memorandum, pp. 3-4). The government points out that in Missouri Pacific, the Court concluded that the value of the stock given up in exchange for bonds "has authoritatively been found . . . [by the

Interstate Commerce Commission] to be not less than the maturity value of the bonds exchanged" (433 F.2d at 1326). The government says that in the case at bar the SEC similarly found that the new debentures of plaintiff were the "equitable equivalent" of the preferred and preference shares in exchange. Thus, the government says that on the one issue left by Judge Mansfield for trial, defendant is entitled to summary judgment.

The argument for the government is without merit.

The second decision in Missouri Pacific has nothing whatever to do with the case at bar. This second decision accepted the reasoning of Judge Mansfield on another point, not now in issue here. The value of the stock there given in exchange had already been determined by the Interstate Commerce Commission; no trial was necessary to find this value. The Interstate Commerce Commission had made this determination (290 ICC at 578): ". . . the value of the stock is fixed at $250 per share in new securities".

In the case at bar the inquiry is: did the SEC determine the value of the preferred and preference stocks of plaintiff received in exchange for its new debentures?

Judge Mansfield has already determined that the answer to this inquiry is "no". Among other things, his opinion stated (316 F.Supp. at 68):

> "Nor did the SEC's determination that the plan was fair and equitable to all parties and that the debentures were the 'equitable equivalent' of the rights surrendered

imply that the debentures were worth their face value at the time of issuance. It merely meant that their discounted value was approximately equal to the value of the properties received in exchange."

The motion of defendant is in all respects denied.

SO ORDERED.

Dated. New York, New York
June 21, 1971

INZER B. WYATT
United States District Judge

jgrf

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

----------x

CITIES SERVICE CO.,

Plaintiff,

-against-

UNITED STATES OF AMERICA,

Defendant.

67 Civ. 4606

----------x

BEFORE:

HON. CHARLES H. TENNEY,

District Judge

July 17, 1972 - 10:30 a.m.
New York, New York

APPEARANCES:

CASEY, TYRE, WALLACE & BANNERMAN, ESQS.,
Attorneys for Plaintiff,
BY: ROBERT J. CASEY, ESQ.,
THOMAS E. TYRE, ESQ.,
JAMES W. ROBINSON, ESQ.,
RONALD BLASI, ESQ.,
Of Counsel.

WHITNEY NORTH SEYMOUR, JR., ESQ.,
United States Attorney for the Government,
BY: DANIEL H. MURPHY, II, ESQ.,
Assistant United States Attorney.
-and-
SAMUEL J. WILSON, ESQ.,
Assistant United States Attorney.

MR. CASEY: Plaintiff is ready.

MR. MURPHY: The United States is ready, your Honor.

MR. CASEY: Your Honor, I am Robert J. Casey, counsel for the plaintiff. In view of the fact that we have a very narrow issue of fact and that the matter will be developed through expert testimony, it occurs to the counsel for the defendant and us that it might be helpful to have a short pretrial conference in your chambers.

THE COURT: All right. We will do that right now.

(Whereupon, a recess was taken.)

MR. MURPHY: Your Honor, this is a trial pursuant to an order entered by Judge Mansfield after he decided motions for summary judgment made by each side, the Government offers the motion papers by the United States, which has been marked Defendant's Exhibit A, and the motion papers by plaintiff Cities Service, which has been marked Defendant's Exhibit B.

THE COURT: I take it there is no objection.

MR. CASEY: No objection.

(Defendant's Exhibits A and B for identification received in evidence.)

xx

MR. MURPHY: Your Honor, further, this is a question of fact as to the loss suffered by taxpayer arising out of an exchange.

The Government has three expert witnesses who have each prepared reports in support of their opinions, and the Government offers those three reports at this time.

MR. CASEY: We have no objection to the admission of the reports of expert witnesses O'Farrell and Goulston except as to the weight of the report.

However, we do have an objection to what we understand to be the "Report of the third witness," and I think it would serve us better if Mr. Murphy restricted his proffer at this time to the two reports to which there are no objection.

MR. MURPHY: The Government offers at this time Defendant's Exhibit C for identification, which is a valuation report of Mr. O'Farrell of the Internal Revenue Service. This has already been shown to opposing counsel and has been exchanged.

(Defendant's Exhibit C for identification received in evidence.)

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MR. MURPHY: The Government also offers Defendant's Exhibit S for identification, which is a

report by Leo Goulston, also of the Internal Revenue Service, which has been shown to opposing counsel.

(Defendant's Exhibit S for identification received in evidence.)

MR. MURPHY: The Government also offers Defendant's Exhibit E for identification, which is a deposition of an expert witness Marvin Chandler, taken pursuant to subpoena in Chicago, Illinois on June 28, 1972.

MR. TYRE: Objection.

THE COURT: What is the basis of the objection? Is this witness available?

MR. MURPHY: No, sir. We have also exhibits to this deposition which show that this man's business address is in Aurora, Illinois and his home address is in Glen Ellen, Illinois, and he is not in New York City or within 100 miles of the courthouse.

THE COURT: Is there any cross-examination? Were the plaintiffs present at this deposition?

MR. MURPHY: Yes, they were present and there was some cross-examination.

MR. TYRE: If your Honor please, our objection is based on the proposition that this type of evidence has no probative value in this case. The background

of this so-called exhibit is somewhat tenuous and before the Court would admit it in evidence we would like to explain to the Court what the source and background of this material is.

THE COURT: All right. But, after all, in the final analysis it is up to the Court to weigh the evidence and give whatever weight is to be given to it.

But I am perfectly willing to hear you on the matter.

MR. TYRE: If the Court please, the proposed depositions were taken, the proposed deposition of Mr. Chandler was taken in Chicago in June of this year. At that time plaintiff objected to any reference or inclusion of a report that was made by the firm of Reis & Chandler in 1947.

To give you some background of the matter, in 1947, when the Cities Service Co. was required to register with the Securities and Exchange Commission, there was a plan of corporate simplification that was submitted and there were hearings held.

At that time the preferred and preference shareholders employed an attorney by the name of Richtenthal. Richtenthal, in turn, employed the firm of Reis & Chandler, who were then security analysts,

to assist him in the preparation of that hearing.

Now, the hearings progressed and the people or the personnel of Reis & Chandler were not used in the hearing before the SEC.

However, they did apparently do some work to the aid and assistance of Mr. Richtenthal. Accordingly, they applied for a fee award.

In support of their application for the fee they outlined the testimony that they would have given if they were called upon. The report, or petition, was not submitted as evidence of any truth of any fact. It was only submitted to show in outline form what they would have done if they would have been given the opportunity and if they were needed.

Incidentally, it should be kept in mind that the firm of Reis & Chandler is a corporation. The report, or the outline, was prepared by corporate employees.

In any event, it was specifically not submitted to the SEC to prove anything. It was not subjected to cross-examination.

Now comes the present case and the defendant proposes to call Mr. Chandler as an expert witness, to hire him. He refused. So they took his deposition and are attempting to get this unused report from 1947

into the record in this case.

We told Mr. Murphy at the time of the deposition that there is no way that we can cross-examine the witness, or the proposed witness, on the basis of an outline that was never used. We told him at the time that there is no probative value to such a report. It is not subject to any kind of judicial scrutiny whatsoever.

And furthermore, it appears to be contrary in its tenor -- we don't know for sure, but it appears to be contrary to the final findings of the SEC.

THE COURT: Does this go to the entire deposition or is this just one facet of the deposition?

MR. TYRE: We don't see any connection between the deposition and the report, you see. What happened, at the taking of the deposition --

THE COURT: Well, are you objecting to the deposition itself or are you objecting to the inclusion in the deposition as an exhibit of this 1947 report?

MR. TYRE: I am primarily objecting to the inclusion of the report because we are unable to cope with it, we have no way of connecting it up with the deposition.

THE COURT: All right, I'll hear from the Government.

MR. MURPHY: Your Honor, this case arises out

of an exchange of preferred stock for debentures. The preferred stock and the debenture holders disputed the terms of the exchange before the SEC.

The expert hired by the preferred stockholders was Mr. Marvin Chandler and Mr. L. Sanford Reis of the firm of Reis & Chandler.

The Government proposed to take Mr. Chandler's examination to find two things:

One, as an issue of fact, what was the opinion which he expressed in 1947 to the preferred stockholders as to the value of that exchange; two, what is his opinion now as to that 1947 transaction. One is to a fact of which he is eminently qualified since he was the expert for the opposing side, to the taxpayer here at the SEC proceedings; two, presently, as an expert opinion, on opinion evidence, as to the issue in suit before this Court.

His support for his opinion is set forth in an outline presented to the SEC. That outline is a public record, one; two, it was prepared by the firm of Reis & Chandler, which is now a firm employed by taxpayer as an expert in this very case; three, it was identified as an exhibit in a deposition taken by Mr. Reis one month before this deposition of Mr. Chandler's took place.

Now, Mr. Chandler said that he testified

orally. My opinion is as such: He gave his reasons for his opinion. He also incorporated separately, independently of his oral testimony, the reasons set forth in the outline of the SEC affidavit put in by Reis & Chandler.

The Government would propose --

THE COURT: In other words, he adopted the report.

MR. MURPHY: As well as testifying independently of the report he also testified, shall we say, dependently upon the report. Those are all tentative grounds.

THE COURT: And he was cross-examined.

MR. MURPHY: And he was cross-examined by our opponents at that time.

Now, the Government offers, or would propose to put in, both the deposition and his oral testimony on opinion and would also ask to put in the report which is an exhibit to this deposition.

THE COURT: All right, I'll overrule the objection and I'll take it. He adopts it as his own and he can be cross-examined on it. I assume that it would come into evidence at any rate on cross-examination if the plaintiffs plan to call the company that actually prepared the report as an expert witness.

MR. TYRE: If your Honor please, may I note an exception.

THE COURT: Yes.

MR. MURPHY: Defendant's Exhibit E is the deposition of Mr. Chandler taken pursuant to subpoena in Chicago on June 28, 1972.

(Defendant's Exhibit E for identification received in evidence.)

MR. MURPHY: And Defendant's Exhibit D is the subpoena pursuant to which this deposition was taken.

MR. CASEY: No objection.

(Defendant's Exhibit D for identification received in evidence.)

MR. MURPHY: Defendant's Exhibit F is a listing of various expert testimony given by Mr. Chandler made an exhibit at that deposition.

MR. TYRE: No objection.

(Defendant's Exhibit F for identification received in evidence.)

MR. MURPHY: Defendant's Exhibit G is a resume of Mr. Chandler's qualifications, also made an exhibit at that deposition.

MR. TYRE: No objection.

(Defendant's Exhibit G for identification

received in evidence.)

MR. MURPHY: Defendant's Exhibit J is the petition of Reis & Chandler submitted to the SEC, which contains the outline of the proposed testimony by Mr. Chandler.

MR. TYRE: Plaintiff's objection to that has been noted.

THE COURT: Yes.

(Defendant's Exhibit J for identification received in evidence.)

MR. MURPHY: The Government also has a trial memorandum which it submits at this time.

MR. CASEY: May it please the Court, this case is before the Court on a very narrow issue of fact pursuant to an opinion and order by Judge Mansfield dated July 24, 1970. We are here to establish whether there was a peculiar value to Cities Service Co. in eliminating from its capital structure preferred and preference stocks on which there was substantial dividend arrearage.

It is the plaintiff's position that the elimination of the preferred and preference shares was of no value to Cities Service Co. as an entity no matter what impact it had on the value to the old preferred shareholders and new bond holders, of their securities in

the market; that as an entity Cities Service Co. was worse off after the issuance of the debentures and the elimination of the preferred and preference shares than it had been prior to that elimination.

It should also be noted that since Judge Mansfield's opinion there have been several cases decided by the Tax Court, the Court of Claims and some District Courts which support Judge Mansfield's finding that the discount here is to be measured by the value originally received by Cities Service, the fair market value of the property originally received by Cities Service on the issuance of its preferred and preference shares.

We would like, your Honor, permission to file a brief on the subject, if it is appropriate, after the trial.

We would like at this time to submit in evidence certain expert reports. The Plaintiff's Exhibit 1 would be the report of Mr. William R. Fields.

MR. MURPHY: No objection.

THE COURT: Received in evidence.

(Plaintiff's Exhibit 1 received in evidence.)

MR. CASEY: We would offer as Plaintiff's Exhibit 2 the report of Stone & Webster Management

Consultants, Inc. to be presented here by the witness William Gill.

MR. MURPHY: No objection.

(Plaintiff's Exhibit 2 received in evidence.)

MR. CASEY: We would like at this time to call as a witness Dr. Jules Backman.

J U L E S B A C K M A N, called as a witness, being first duly sworn, was examined and testified as follows:

MR. CASEY: I would like you to mark this for identification as Plaintiff's Exhibit 3.

(Plaintiff's Exhibit 3 marked for identification.)

DIRECT EXAMINATION

BY MR. CASEY:

Q I hand you Plaintiff's Exhibit 3 and ask you to identify it.

A This is a partial list of some of my writings. The first page shows a number of books and the following four pages list some 67 articles which have appeared in various academic journals.

Q Did you prepare this list?

A Yes, sir.

MR. CASEY: I would offer this in evidence as Plaintiff's Exhibit 3.

MR. MURPHY: No objection.

(Plaintiff's Exhibit 3 for identification received in evidence.)

Q Dr. Backman, would you state your occupation?

A I am research professor of economics at New York University.

Q Do you have activities beyond the academic activities, your scholastic?

A Yes. I act as a consultant at various times to various business organizations and to Government agencies.

Q How long have you been a professor of economics?

A I joined the faculty in 1938. I've been a professor since 1950.

Q Could you state your educational background?

A I hold four degrees from New York University, a Bachelor of Commercial Science 1931, Master of Arts 1932, a Master of Business Administration in 1933, and a Doctor of Commercial Science in 1935.

Q Would you tell us some of the assignments that you have undertaken as an ecomonic advisor and/or business consultant?

A I've acted as economic advisor to the railroads in wage and rate cases and in that capacity testified before Presidential Fact-Finding Boards and before the Interstate Commerce Commission.

I've been a consultant to the steel industry and the coal industry and many public utilitity companies in connection with wage and rate cases.

I've acted as a consultant to General Motors, General Electric, U. S. Steel, ITT, National Steel, Mortgage and Guaranty, Chemical New York, and a large number of other companies.

Q Have you been active in advising companies with respect to mergers and other acquisitions?

A Yes, sir. I participated in key roles in putting together Morgan Guaranty, Chemical New York Trust Company, in connection with many bank mergers, one insurance merger, and to a lesser extent some industrial mergers.

Q Have you advised Governmental bodies in this area?

A At various times I've been head economic consultant to the old OPA during World War 2; I was economic advisor to the Joint Legislative Committee on Taxes in New York State; I've been economic advisor

to the Rate Council of New Jersey in connection with rate cases, where I acted as a rate of return witness over the last couple of years; an economic consultant to the General Accounting Office in Washington; a member of New York Milk Shed Price Committee, which determined prices in New York; Governor Rockefeller's Milk Marketing Committee; I've worked with the SEC for a brief period in its early stages, and advised New York City in connection with some of its wage negotiations; with the policemen and firemen, and a few others of that type.

Q Besides the railroads which you have already mentioned, have you been active as an advisor to trade associations?

A I've conducted a number of studies for economic and trade associations, like the Brookings Institution, Washington, the National Industrial Conference Board, the New York State Bankers, the Association of National Advertisers, the Manufacturers Chemists, the American Potash Institute, Cotton Textile Manufacturers, and a number of others.

Q Have you been called as an expert witness [illegible] testimony on securities and business matters?

A I've testified [illegible] a number of Commissions

committees rather frequently. The Joint Economic Committee, which is a joint committee of both houses; the Senate Anti-trust Committee, the Senate Banking Committee.

I've testified before Presidential Fact-Finding boards in the steel industry and the railroads.

I've appeared before several public utility commissions.

Q Were you employed by Cities Service Company in connection with this litigation?

A Yes, sir.

Q And what were you asked to do?

A I was asked to make a study of the exchange effected in 1947 of the three per cent debentures for three classes of preferred stock and to determine, if I could, what the net benefit or adverse effect was on the company in light of the economic conditions prevailing at that time.

Q How did you approach the study, the analysis?

A Well, I examined the plan of simplification as it was called, I reviewed the decision of the Securities and Exchange Commission, I examined the annual reports of Cities Service at the time to get their current position both before and immediately after the exchange, I reviewed a large number of briefs that were submitted

between defendant and plaintiff, I examined the economic environment by looking at a number of publications that appeared in 1946 and '47, including some in which I had participated or had written, various articles that appeared in the Commercial and Financial Chronicle which reproduced many of the speeches made on the economic outlook at the time, the survey of current business published by the U. S. Department of Commerce, the First National City Bank Economic Bulletin, and some of my own voluminous files.

Q Have you reached a conclusion as to what dollar value Cities Service received on the exchange of its preferred and preference shares for its debentures?

A Well, what I attempted to do was to line up what seemed to me to be the adverse effects and the beneficial effects of the exchange.

In other words, an exchange of this kind has certain effectsupon a company, upon its various options, and I attempted to reach some sort of balance in evaluation of these factors.

Q Would you state what conclusion you reached?

A Well, on balance I felt there was no benefit -- I concluded there was no benefit to Cities Service from this exchange.

One could say that in terms of the circumstances at the time, the balance was slightly negative, but there is no plus that I could see on balance for the company.

Q Will you tell the Court, please, what factors you considered most important in reaching your conclusion?

A Let me summarize the adverse factors first and then the affirmative factors.

First, on the adverse side, a fixed obligation to pay interest was substituted for the optional payments that could or might have been made for the preferred dividends. The preferred stock did not require the payment. The company could defer payments and in fact did over the years.

Secondly, the payment of $3,457,000 in interest would result in a tax saving of 1,313,000 to the company at the 38 per cent rate then in effect, so that in round numbers, the cost to the company was 2,143,000.

In addition, they had the obligation of making a sinking fund payment of a million and a half which meant that the total obligatory financial cost incurred in connection with these bonds was $3,643,000. This was obligatory.

To combat this total, they had the option of issuing a virtually equal, 3,317,000 in preferred dividends. That, of course, would [illegible]

an adverse cash flow to the company of somewhat in excess of $3,600,000.

Thirdly, this drain in cash would affect the company's ability to either pay off debt or to expand plant and equipment.

Fourth, it gave the company a very high proportion of debt. Actually, before this transaction, the company's long-term debt, and I am speaking only of the parent company and not the consolidated company, had long-term debt at that time which was 31.94 per cent of its capitalization. After this exchange, its debt became 40.5 per cent.

In connection with this element of high proportion of debt which was really fantastic for an industrial or for an oil company, because by that time Cities Service was either two-thirds or 70 per cent in the industrial field and was rapidly divesting itself of its remaining utility companies.

This exchange was part of a broader plan, elements of which could have been effected without the exchange. For example, at that time Cities Service [illegible] $43 million in short-term debt [illegible] more than one quarter [illegible]

They also agreed to use the proceeds of the sale of electric utility properties to retire the remaining 5 per cent bonds which were in the neighborhood of $59 million, and that too could have been done without this plan.

Nevertheless, I think I should note that after all of these transactions were completed, that is, the retirement of bonds through cash, the future retirement of bonds from the proceeds of sale from the utility properties, they would have had a debt ratio of 39.3 per cent.

That debt ratio of 39.8 per cent compares with something under 13 per cent for 13 petroleum companies in the Fortune 500 and a ratio that runs in the 25 per cent range for manufacturing companies.

So, even if one ignores the fact these 5 per cent bonds could have been retired without this plan, the company would have had a very high debt.

Now, today we don't think very much of [illegible] bonds. We pick up the paper and every day there are these rather large issues, but in 1967 [illegible] lot of money and this seems to be [illegible] I [illegible] effects [illegible]

Fifth on the adverse side, there were many experts at that time who felt that the economy would go into a post-war tailspin following the experience of World War I. Some businessmen, Sewell Avery come to find as an outstanding illustration, were so convinced of this, I think at that time he sat upon $400 million of cash of Montgomery Ward and just refused to expand the company with dire consequences it turned out subsequently to the company. But this fear of a potential decline is one that could not be ignored by a company that was incurring an obligatory debt of $115 million with the accompanying charges in contrast to the preferred stock situation I mentioned earlier.

Sixth, the indenture for these new bonds did have some provisions which limited the issuance of new debt unless certain levels of earnings were achieved at the time, in the event of a reduction in economic activity, could have been a negative force.

Finally, dividends which could be paid on the common stock could only be paid out of earnings that were earned as of January 1, I believe it was, 1947. So, you couldn't use your past surplus for this purpose in the event that the situation deteriorated.

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following:

First, it helped the company conform to the requirements of the Public Utility Holding Company Act and while as I understand it, the company had applied for an exemption and was in the process of becoming a non-regulated company through its disposal of various assets, it was still a holding company and subject to whatever restrictions would apply to those companies.

Secondly, it was an advantage to the company to pay interest if it was going to make a payment rather than pay dividends because the interest is a tax deductible feature. This is a deductible item in calculating the federal income tax whereas preferred stock, dividends are paid out of income after taxes.

The net cost of the company of bonds, the interest on the bonds and ignoring the sinking fund, would have been, after taxes, 2,143,000, whereas the preferred dividends would have been 2,517,000.

As noted a little earlier, if you allow for the sinking fund, the total of interest plus sinking fund after allowing for the tax factor, would have been

pay dividends because of a large accumulation of almost $50 million in preferred stock arrearages could now obtain dividends if the earnings were forthcoming.

I view these as being the main pluses and minuses as I see it of this program.

Q Having weighed these factors, both plus and minus, could you tell us your conclusion as to the value to the Cities Service Company of the cancelation of its preferred and preference shares and the substitution, therefore, of bonds with interest?

A Frankly, the evaluation of a series of pros and cons of the kind I mentioned cannot be put into a computer and you can't bring out a precise number, but as I tried to weigh these factors, it seemed to me there was no measurable advantage to Cities Service. The intangible plus of coming into better conformance with the provisions of the Public Utility Holding Company's [illegible] at a pretty high price.

Q How do you regard the substitution of the [illegible] obligation for the accumulated arrearages on the preferred and preference shares?

[illegible] a firm claim for a specific [illegible] did not have to be met at any time. Cities [illegible] wanted to, could have passed that out forever.

I don't think they would have, but they could have. In its place you had that part of the $115 million which became a fixed obligation of the company with the debt service that had to be met and met each year if they were not to be thrown in bankruptcy.

Q How do you evaluate the economic climate of the time of the exchange on the value to Cities Service Company of the exchange?

A It seems to me that against a background where many people, eminent people, Sumner Slichter of Harvard, Paul Nystrom of Columbia, Henry Ford, II who is a businessman who said he was concerned about the possible break that might take place, Professor Rodgers of New York University; there were many, who felt there was a serious risk of returning to the kind of situation we had after World War I and even to the depressed situation of the 1930s.

There were others who did not agree with this [illegible] I don't want to imply there was a unanimity [illegible] There was a small minority that felt that [illegible] would not take place.

[illegible] affected by a wide variety [illegible] these days I would be the [illegible] the

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because there were many of them. There were enough of them to put a damper on many types of projects as the kind I mentioned earlier for Montgomery Ward and to indicate that one was taking a real risk when a company added a very substantial amount of debt to capitalization that became seriously unbalanced.

Q Could you tell us what factors that were peculiar to Cities Service Company and this particular transaction you have considered in arriving at your conclusion?

A Well, I view the fact that Cities Service was becoming an oil company and it already reached, as I say, two-thirds or 70 per cent of this position and had committed itself to eliminating the balance of its utility properties.

Utility properties or utility comapnies generally have much more stable earnings than do industrial companies.

It is an interesting fact that in all of the post war recessions, looking at what has happened since the event, the electricand telephone utilities companies have moved upwards in terms of earnings and volume in all of those periods whereas the industrial companies often had serious declines in

profits.

By eliminating that part of its business which was most stable, it would seem to be heading into a more erratic type of earnings performance than it had before. The fact that a utility company might have a very high bond indebtedness and many utility companies can run up to 60 per cent, doesn't mean that a company that is now one-third utility or a little less, can stand the same risk. Even the roughly 40 per cent indebtedness that they would have had after all of thesetransactions were completed was an unusually high one for an industrial company.

Q If Cities Service Company had asked you prior to the exchange to advise them in your expert capacity whether the exchange should have been consummated, what would you have advised?

A I would have told them I didn't agree with all the extreme pessimism but I thought it was a risky operation and I would have advised against it.

Q Do you have any opinion or any idea why the company agreed to the plan?

A There was a great deal of pressure at the time in terms of decisions which the SEC had come down with concerning simplification of corporate structures.

Actually, the SEC, as I recall it, had three objectives, and two of them didn't seem to apply here. One was to get rid of a pyramided security structure so a relatively small investment couldn't control a large superstructure. The outstanding illustration is Mr. Hopson in Associated Gas where for $300,000 in the holding company, it controlled a million-dollar company.

This wasn't the objective of this kind of program.

Another objective often was, was to get a wider dispersion of common stock so a small group couldn't control. The third was simplification of the capital structure. Only the third applied in this situation, because this did simplify Cities Service's capital structure.

Not having been present at the time, I don't know what advice they got from their lawyers, but I can imagine.

Q Is this type of exchange common in your opinion?

A The effort to eliminate preferred stock was not unusual at that time because the Securities & Exchange Commission in one way or another let it be known it wanted a more simplified form of capitalization. That was unusual, instead of retiring the preferred for cash or

for common stock, a very large debt was incurred. I think that was the unique aspect of this particular exchange. I don't know if I am permitted to refer to one of these exhibits that has been entered, but I believe in Mr. O'Farrel's exhibit, he has an appendix in which he shows eight or ten exchanges and I was interested to note in practically all of them, an exchange was made for cash or for preferred stock in one case a different type of preferred stock and I believe in one case he said a bank loan had been undertaken or collateral trust. Securities had been issued, but I hadn't a chance to find out what the nature of those securities was.

Overwhelmingly, it would be what one would expect.

Q Would you evaluate the risk to Cities Service Company of undertaking this, what is, I guess in your opinion, an imbalance between debt and equity at this time?

A Well, if they guessed wrong, the ultimate risk is bankruptcy, because the risk of heavy debt also implies the obligation of payment. If the payments aren't made, bondholders have recourse to the courts.

Q Which sets them apart from preferred shareholders?

A Yes, very definitely.

MR. CASEY: Your witness.

MR. MURPHY: Your Honor, could I have a five-minute recess

THE COURT: All right, we will have a short recess.

(Recess.)

CROSS EXAMINATION

BY MR. MURPHY:

Q Dr. Backman, my name is Dan Murphy. I am an assistant United States Attorney representing the United States interests in this matter.

May I have your birth date?

A May 3, 1910.

Q Referring back to your testimony given earlier this morning on your qualifications, were you ever a financial officer of any company, private company?

A No, sir. I say, "No, sir," actually I have been involved in companies where I have financial responsibility but I wouldn't be considered to be financial officer in the sense that term is used today.

Q What do you mean by financial responsibility?

A Well, I had an economic research organization from 1933 to 1935. I had the problem of raising money,

spending it, doing everything else but I interpreted financial officer in the sense of a financial treasurer, an officer of that kind.

Q Have you read Judge Mansfield's opinion in this matter?

A Yes, sir.

Q I take it you were asked by Cities Service to make a study of this exchange and determine the net benefit or adverse effects to Cities Service?

A That is right.

Q Is that a fair statement?

A Yes.

Q Then what you did was, you balanced the adverse effects on the company as you saw them versus the beneficial effects?

A That is right.

Q And you did that as of what time, sir?

A As of the time of the exchange, 1947.

Q May 27, May 28, 1947?

A That is right.

Q And your conclusion, looking at it as of May 23, 1947 was that?

A That on balance, I couldn't see there was any measurable benefit to the company. To me, thinking in

terms of the company itself, it had assumed a slightly negative posture.

Q And this was thinking as of the general trend of things in 1947; is that correct?

A That is what I attempted to do by reviewing the literature and trying to steep myself, once again, in the environment of that time. I was very active at the time and had a rather good recollection of what was going on.

Q So your testimony is really as sort of an historical expert in 1947 would have testified on the exchange as opposed to what a modern day person would have thought about it?

A I think that is what a modern day person would have testified in 1947. I don't understand the difference, frankly.

Q Certain things which the people in 1947 might have thought would be bad for a company to get into, experts today in 1972 wouldn't feel were quite as bad for that company, isn't that right?

MR. CASEY: Your Honor, I think that is a very difficult question for the witness to answer because I can't understand it.

THE COURT: This isn't 1947.

MR. MURPHY: I would like to find out what sort of standards Dr. Bachman would have used.

THE COURT: Why don't you ask him.

Q What were the standards of evaluation you used in determining this?

A I examined what were representative capitalizations for industrial companies and oil companies in 1947. I tried to reconstruct in my mind what $115 million looked like in 1947 contrasted to today. I examined the difference between a compulsory payment and an optional payment in terms of a company's well being and I would look at exactly the same standards in 1972.

Q One of your adverse factors was that as a result of this exchange, there was a high proportion of debt; is that right?

A Yes, sir.

Q By the way, did you prepare a report on your opinion in this case?

A No, sir. What I did was prepare a series of notes and I was told a report wasn't needed. I was very happy not to have to prepare it.

Q Do you have your notes here, sir?

A I have the equivalent of the notes. I had some things typed up.

MR. MURPHY: I ask that those notes be marked as Defendant's Exhibit T.

(Defendant's Exhibit T was marked for identification.)

BY MR. MURPHY:

Q You talked about the high proportion of the debt with respect to this type of an exchange.

A Yes.

Q When you consider the adverse effects of debt with a company, what kind of things would you consider?

A Well, the main things you would consider would be the threat of inability to meet either your interest or sinking fund payments. When the debt is due 30 years from now, you would give the payment of principal less weight and thus I gave weight primarily to the current requirements.

Q When evaluating the requirement of payment of interest, what sort of things would a company think of when they decided to issue debentures?

A Well, they would want to know whether or not they were going to earn the interest. They would think that the interest had certain tax advantages as compared with preferred stock dividends. They would want to look at their entire capitalization because what you [illegible]

moment of time is only a prelude to what you are going to do in the future and if you become over-borrowed as I think they were at that time, you create problems for the future and this isn't anything that applies just to '47. We have seen that with dozens and dozens of companies within the last two or three years.

Q And if a company is forced to go into a situation where they might become overborrowed, to use your phrase, what would be the best time to get into that situation?

A The best time would be at the beginning of an economic cycle when they could hope over the following year or two or three years to accumulate some reserves to protect themselves against it.

Q What other time would be the best time as far as interest rates are concerned?

A Well, the best time is when interest rates are low, obviously. If you could get in when interest rates are low, it is better than when interest rates are high. Even though they are deductible.

Q When you think about the risk of not being able to cover those interest rates, the actual rate itself is important to accompany, isn't it?

A Yes, that is rate, and we must remember in

1946 we had 15 years of declining interest rates behind us and the tendency on the part of people is to expect in the future what you have had in the immediate past. So even a three per cent interest rate may have looked high in 1946.

Q What was the status of the interest rate in 1946 and 1947 compared say to the depression years, the impression interest rates?

A It was lower.

Q It was lower in '46 and '47?

A That is right.

Q You are a historian, aren't you?

A I am an economist.

Q Are you also an historian by profession, of economic history?

A I have examined the numbers, if that is what you are asking.

Q From 1947, how far back in time in the United States would you have to go to find interest rates as low as they were when the exchange occurred?

A I would just be giving you a guess. It would be some time before the turn of the century. I don't think you would have found them at any time with the possible exception of a year or so in the '30s when they

may have jiggled a little higher or lower. You realize you are talking about a general level. I would say they were probably at the lowest level of all time at that time.

Q What was the business of Cities Service Company at this time, the parent, the taxpayer company?

A It was a holding company, which held securities in oil companies, electric companies, gas properties.

Q What did it get income from? What was the source of its income?

A Overwhelmingly, interest and dividends.

Q You compared the debt position of Cities Service with positions of other companies, did you, sir?

A I compared them with manufacturing generally and with petroleum companies specifically.

Q Did you compare them with other companies whose sole source of income was dividends and interest?

A No, sir, I did not.

Q Now, your second adverse factor was that a high proportion of debt would inhibit investments of the borrower in plant and equipment, is that right?

A If I remember correctly, my third factor was that if you had a smaller cash flow, you wouldn't have as

much money available either to invest in plant and equipment or to retire debt.

Q And you considered that Cities Service Company would have less money to invest in plant and equipment as one of the factors that was adverse resulting from this exchange, is that correct?

A You must remember the way they invested in plant and equipment is by putting money into a subsidiary. I didn't mean that they invested directly, because, as you've indicated, Cities Service itself was a holding company.

Q Did you compare, as part of your research in this matter, the position of Cities Service say in 1940 with its position in the end of 1946?

A Well, I reviewed its annual reports for several years before. I may have gone back to '40. I don't recall.

Q Do you recall what the consolidated surplus of Cities Service was in round figures in 1940, or would you like to have your notes?

A I don't recall. You are talking now about the consolidated or the company itself?

Q No, the consolidated.

A For the whole system?

Q Yes.

A I don't recall the number. I had the annual report, I could check it.

Do you want me to look at it?

Q If I give you the statistics, subject to check by my opponents, that the consolidated surplus increased from $20,496,000 in 1940, for the whole system, to $131,560,000 in 1946, 20 million to 131 million consolidated surplus they had in the corporation, I ask you, did you consider that increase in reaching your decision as to the effect of this exchange?

A I don't think the increase has any bearing on it. I noticed there was a large increase. I don't remember the exact figures.

Q But you did not consider it.

A No, sir.

Q I recall you giving testimony as to Sewell Avery in Montgomery Ward. What was that story, sir?

A Mr. Avery became famous in World War II for being carried out of his office by the troops, as I recall, and after the war became even more famous when he refused to invest the large amount of money which Montgomery Ward had available in expansion because he feared the economy was going to collapse, and then Sears Roebuck just took

the ball away from Montgomery Ward.

It is a classic case of what turned out to be misjudgment.

Q Would you say that Sewell Avery was the leading advocate of your pessimistic pessimists, the phrase you used?

A Yes. I think Mr. Avery was one of a number of businessmen who felt very strongly that way. There were a few economists who joined him.

Q I also notice that one of your adverse effects was that dividends on common could only be payable for earned surplus earned after January 1, 1947; is that right, sir?

A Yes. I indicated that was a restraint.

I did not think it was the overwhelming one. That would depend upon what earnings were. They couldn't draw on the preceding surplus.

Q However, after this exchange their dividends could be issued on the common stock, isn't that correct?

A That's right.

Q Before the exchange, dividends could not be issued, is that correct?

A That's why I put that on the favorable side, you may recall.

Q That was the point on your favorable side.

That's right.

Q But you said as against thawt the company could only issue dividends out of earned surplus after January 1, 1947, is that right?

A That's right. The reason why I called attention to that -- I may have forgotten to mention it -- I am also a director of a bank and have the problem of declaring dividends, and we are rather reluctant to get too generous with dividends unless we think we have a little left in the kitty.

So that the fact that you couldn't touch what was available in the way of surplus, whatever form it may have taken, prior to January 1 of 47 becomes a form of constraint.

Q Would the amount of restraint which the directors would have on declaring dividends be a function of the sort of business the corporation was in?

A Yes, I think that would be a factor.

Q And comparing a holding company, with its only income from interest and dividends, with an industrial company, then the directors of the industrial company should keep more in the kitty than somebody in the holding company, isn't that correct?

A I think this really depends upon the company and the relationships to the subsidiaries.

If it had subsidiaries who were having trouble borrowing, assuming that things had gotten bad, then I would think they would want to make sure that the empire wouldn't collapse because of something that took place with one of the subsidiaries and they would make some money available.

So that it really depends again on the economic circumstances. But ordinarily the holding company, unless it is engaging in a vigorous expansion program, where it uses the cash for acquisitions, could pay out a higher proportion than could an industrial company.

Q You compared the obligation of the corporation to pay its accrued dividends and dividends on the preferred stock with the obligation of the corporation to pay interest on its issued debentures as a part of your study, didn't you, sir?

A Yes, sir.

Q And was it your opinion that the Cities Service could have ridden accrued dividends out forever without paying them if, say, they were so inclined?

A Unless somebody found some way to go to court and stop them, they could have done it forever. Of course

the common stockholders would have gotten nothing. There have been cases where the preferred stockholders ended up with nothing and the company, if it went down the drain, finally got nothing.

So it could be done, and I think we have to keep in mind that if Cities Service finally got out from under the Public Utility Holding Company Act, which would have been their fate, say, three or four years down the road when they disposed of the various subsidiaries which they had agreed to sell, that at that point they would no longer have been under the constraint of purchasing in the open market their preferred stock. As I recall, there was a limit of no more than about $50,000 worth of stock that could be bought by a holding company.

But if they no longer were registered they could do what they had done during the '30s, when they bought in large quantities of the preferred stock.

So that it doesn't necessarily follow that the preferred stock stays out forever. It depends on the circumstances.

Q Actually, if the company is successful in the policy, it is smart business for the company not to pay dividends on preferred stock, discourage the stockholders from thinking they will ever get any preferred dividends,

and then buy up that preferred in the market, isn't that correct, at a lower price?

A Well, I don't know what the term "smart business" means there. Frankly, I don't know of any companies that have deliberately issued preferred stock with that in mind.

But I think we have to recognize a very important fact about this entire environment, and I suppose as an older fellow I may remember it rather vividly, and that is that when we came out of World War II the predominant type of thinking was the thinking of the '30s.

The reason why the Employment Act of 1946 was passed, the overwhelming reason, was a fear of a return to the depressed conditions of the '30s and the thinking of the '30s and the fear of what would happen if the economy really turned down after the war stimulated boom, which "Was supposed to be temporary," subsided.

It was something that dominated a great deal of thinking. In fact, it dominated a great deal of thinking right into the '50s. And as the period became further removed, the kind of chances you were willing to take as a corporate director or as a corporation changed rather significantly.

So that I think we have to view this not so

much as a company being smart or sharp but remembering the experiences of the '30s, when many important companies had great, great difficulties.

can see that a conservative point of view would say "Let's hold on to the cash."

Q But it was part of your thinking that the Cities Service could have refused to pay the accrued dividends on the preferred stock for the foreseeable future, isn't that correct?

A Let me put it this way:

What was part of my thinking was not that they could refuse to pay for the foreseeable future, but they had the option of not paying, whereas on the interest that option did not exist.

In other words, if they resumed dividends on the preferred, let's say they decided to pay $6 in 1947 and without paying any arrearages at the moment, and then in '48 things didn't look so good, they could stop that.

But the three and a half million involved an interest, sinking fund and things of that kind they could not stop. So it is not a matter of saying forever they wouldn't pay this thing. Rather it is a matter of having flexibility.

Q In fact, as a result of this exchange, do you know whether the dollar amount which was payable in preferred dividends by Cities Service was more or less than the dollar amount paid on interest on the debentures exchanged for that preferred stock?

A They were approximately the same. I don't have my notes. There was a few dollars difference. And, as I indicated, when we allow for the tax effect, the specific amount net paid ~~on dividends~~ in interest was something like two million one against three and a half million for the preferred.

And when you added the sinking fund of a million and a half, so that even after taxes it was three million six against about three million five.

Incidentally, if you weren't earning any money, you would get no tax benefits, in which case you would be paying out five million instead of three and a half.

Q Exactly how did that sinking fund work?

A Well, they were to either turn over to the trustee a million and a half in cash or securities each year, as I recall. The ordinary way a sinking fund works is you agree to buy in or to make available to the

trustee whatever the amount is, in this case a million and a half.

It is a compulsory part of the deal. You don't waive the sinking fund without getting into trouble.

Q They could have satisfied that sinking fund either out of the debentures they issued as a result of the exchange or by dollar payments, isn't that correct?

A Well, the only way they can satisfy it out of the debentures issued is by buying them.

Q On the market.

A That's right. Unless they call them in.

Q And the minute they bought them on the market they would get credit for the face amount, say one million five, is that correct?

A For the retirement, yes.

Q Well, if they just paid the cash, they would have to pay the full one million five in cash.

A That's right.

Q So that to the extent that the debentures on the market sold at less than par, it was more favorable to Cities Service to purchase on the market than it was to pay the $1,500,000.

A To the extent that they were alert to their

opportunities.

Q When were these debentures exchanged due?

A In 1977, as I recall, another five years.

Q Did you consider whether Cities Service could have refused to pay the accrued dividends due on its preferred stock from 1947 all the way up through 1977, as part of your decision in this case?

A No, sir.

Q In fact, how long had the preferred dividends been passed by Cities Service in 1947, if you recall?

A If I remember correctly, from about 1932, with the exception of a payment of half a dividend either in '40 or '41.

Q So it had already been passed for 14 years, and if Cities Service refused to pay the dividends for the whole time of their debentures, if they chose not to go into the exchange, it will be a total of 44 years, is that correct?

A If they waited for that whole period, it would have been 44 years.

MR. MURPHY: One minute, please, your Honor.

(Pause.)

Q Do you recall giving testimony earlier on direct examination that the ordinary or usual course of

purchasing back the outstanding preferred stock of a corporation, or redeeming that stock, was by cash payments?

A Usually cash. Sometimes they are exchanged for common stock.

Q So this transaction was unusual. Instead of paying cash or common stock, they issued debentures, is that correct?

A I wouldn't say it was unusual to the extent that no one else had ever done it. I didn't run into any recently. But you can do almost anything in the field of finance.

Q But in 1947?

A I would have thought that was the wrong way to do it.

Q Did you consider whether the preferred stock had voting rights when you made your decision and your opinion?

A I didn't give too much weight to that, no. I don't recall examining it.

Q You didn't examine it.

You also talked about Cities Service, or the holding company, making loans to the subsidiaries if a subsidiary had trouble making loans on its own. Do you

recall that?

A That was in response to your question.

Q In fact, what was the financial condition of Cities Service's subsidiaries in May 1947?

A I really don't recall other than the fact that, as I read their annual reports for '46 and '47, each of the companies seemed to be going out borrowing money and selling securities at interest rates in the general way that we've talked about. But I didn't examine the individual financial situation of each of these subsidiaries.

Q What do you mean by "each of the subsidiaries seemed to be going out and issuing stock and borrowing money"?

A If you look at the annual report for Cities Service, you will find that Toledo Edison borrowed money also coming due in 1977. And they have in much of their annual reports in that period, I believe under the heading of Financial Factors, a list of the transactions of the subsidiaries, and some were making bank loans, some were paying them off, some were selling bonds. This is what I had in mind by their financial transactions.

Q So would you say that in this case of Cities

Service it was a situation where the subsidiaries were forced to borrow their money from the parent rather than borrowing it from the marketplace?

A No. Most of these were from the marketplace, and all I said was that the availability of moneys available for investment in those areas would be restricted. I had no information on how much had been invested, currently.

MR. MURPHY: Thank you very much.

BY MR. CASEY:

Q Dr. Backman, could you tell us whether in your expert opinion it is wise for a subsidiary company, an operating company, to transfer all of its net income and all of its liquid retained earnings to the parent company as a matter of annual practice?

A Well, actually they couldn't do it. If you had public utility subsidiaries, electric and gas companies, you would hear pretty quickly from the local public utility commissions, apart from the SEC.

Secondly, you retain earnings for a purpose, or a series of purposes. One is to equalize dividends over time, to make sure that whatever monies you are paying as dividends will not be extremely erratic.

Secondly, you retain earnings for reinvestment in the company. And these companies apparently had investment needs, financial needs. Part of their earnings would be used for that purpose.

The consolidated surplus of the entire system isn't available to Cities Service, if this is what you are asking about. All that is available to the parent company is what is paid out, and the amount that can be paid is also affected by, or is primarily affected, by the dividends that the subsidiary declares.

2 jgrf Backman - redirect

If Cities owns all of the stock, they can influence the dividends, of course.

MR. CASEY: May I have just one moment?

(Pause.)

MR. CASEY: I have no further questions.

THE COURT: Thank you.

(Witness excused.)

MR. CASEY: Your Honor, we propose now to call William Fields to the stand.

W I L L I A M R. F I E L D, being first duly sworn, was examined and testified as follows:

MR. CASEY: The testimony of Mr. Field will be fairly extensive. I just wanted to inquire whether we should start it now.

THE COURT: I think so. I think we'll go to a quarter to 1:00 and then adjourn to 2:00 o'clock.

DIRECT EXAMINATION

BY MR. CASEY:

Q Mr. Field, would you state your occupation?

A I am a vice-president and economic analyst with H. Zinder Associates, Inc., business address 1828 L Street, Northwest, Washington, D.C.

Q Mr. Field, I hand you a copy of Plaintiff's Exhibit 1, which has already been admitted in evidence,

and I direct your attention to Appendix B.

A Yes, sir.

Q I ask you if you have, yourself, prepared that portion of the Plaintiff's Exhibit relating to your education and professional experience?

A Yes, sir, I did.

Q Mr. Field,were you employed by Cities Service Co. in connection with this proceeding?

A Yes, I was.

Q And what were you asked to do?

A I was asked to determine what valuo, if any, Cities Service Company realized upon the exchange of $115,246,950 of three per cent 30 year debentures on May 28, 1947 for its outstanding preferred and preference stocks over and above the $45,323,846 received upon the original issuance of the said preferred and preference stocks.

Q Will you explain your approach in reaching your judgment and opinion in this matter?

A My approach was to try to determine the value of any consideration received at any time by Cities Service. I stopped to think about the question of consideration and I felt it did not necessarily have to be in cash; it might have been in the form of intangibles

or tangibles.

I did think, though, that value would have to some day be converted or somehow be converted into a monetary value. I somewhat looked upon it the same way we do of appraising a piece of property, a going business concern. There is a little ditty in economics, evaluation we often use. The value of a thing is the price it will bring.

So approaching it from the willing buyer, willing seller concept, I tried to determine then what the value to Cities Service was.

I thought a very important step was to separate the face value of $115,246,950 into four basic components. For your information, the basic components are listed on page 2 of my report. The first component was the original discount caused by face value in excess of fair market value. That component was $13,366,154.

The second basic component was the call premiums. That amount to $6,885,000.

The third component was accumulated arrearages of $49,671,950.

The fourth component was original fair market value of the consideration paid of $45,323,846.

When you add those all up you get the $115,246,950.

5 jgrf Field - direct

Now, I want to emphasize, in so doing I don't wish to imply that the $115,246,950 was a true value figure and that that amount represents a payoff or redemption of the preferred and preference stocks. I am merely using it to show the components of that $115 million odd dollars.

Q Looking to the four components, would you tell us how you derived the original item of $13,366,000 representing the excess of stated or par value of the preferred shares over the fair market value of the property acquired?

A Yes, sir. I took the $58,690,000 stated value and I merely subtracted from it the $45,323,846 of the amount received for the preference and preferred stock and got the $13,366,154.

Q Do you consider this $13,366,000 as representing consideration received by Cities Service Company when the preferred and preference shares were acquired?

A No, sir, I definitely do not. Firstly, by definition it seems that the $13,366,154 could not be consideration if, in fact, the aggregate value which Cities received was only $45,323,846.

Q The next component of value in your consideration was the callpremiums of $6,885,000, is that correct?

A Yes, sir.

Q Would you tell us how you analyzed this item and its impact on the company?

A Yes, sir. I took first the derivation of it. I went to some fairly well known investment services, Moody's Public Utility Manuals and Standard & Poors Corporation Records, and I obtained the call premiums and the number of shares outstanding both at the end of the year 1946, and these were also still outstanding and still the call premiums at the time of the exchange, and I simply, by arithmetic, multiplied the number of shares of each of the components, the preferred and preference stock, by the per share call premiums to get an individual call premium for each of the components of stock.

And then I merely summarized or summated, added those, to come up with $6,885,000 shown on page 4 of my report.

I again asked myself as an analyst did I consider that that represented consideration received by Cities Service, and again I came to the conclusion it does not.

By its nature call premium is a penalty. It is a penalty the company would have to pay if it called the stock.

At no time did Cities Service receive anything in consideration equal to that amount.

My further analysis, which I've done in Section 3 of my report, gave me a conclusion, or caused me to conclude, that it would have been highly unlikely that, even if the company were to call its stock, it would pay face value.

For a long period of time prior to the date of the exchange the company's financial performance, which I evaluate in that section, indicated it was not financially feasible or advisable for the Cities Service Company to have called the stock.

Q If it had been in Cities Service' interests to acquire the stock, what approach was available to the owner calling it?

A For many years the obvious one was that it could have actually gone out into the market, as it had done in the past, and purchased the stock.

Assuming the lack of the whole scheme of SEC regulation leading up to the simplification plan and the exchange, it could have even been assumed that the company forever thereafter could have purchased its shares.

And even assuming that there was going to be

8 jgrf Field - direct

a continuation of SEC regulation, there was still the avenue of purchase of stock up to the exemption that Rule U42 allowed, and that was $50,000 a year. And at the low prices this still could have enabled a substantial buying back of the preferred and preference shares.

Q And your conclusion as to characterizing the call premium as consideration to the company was what, please?

A It could not be considered, in my judgment, consideration paid to the company or received by the company.

Q Could I draw your attention to the dividend arrearages, accumulated arrearages of $49,672,000?

Would you tell us how you analyzed that and its impact on the company?

A Yes, sir. This was the one that took the most time, and the remaining part of the report actually is very much related to that question.

The first step, of course, was to merely determine the amount of the arrearages. To do so I again took the Moody's Public Utility Manuals and Standard & Poor's Corporation Records, checking one against the other to make sure they both showed the same, and found what the number of shares and the arrearages per share were

at the end of 1946, and those were also the same on the date of the exchange.

And I again,by mere arithmetic, multiplied the number of shares by the arrearages to get the total arrearages for each of the issues. I then merely summated and got for all issues the total arrearages of $49,671,950.

Q Do you consider this accumulated arrearage amount of $49,671,000 as representing consideration to Cities Service when it acquired the preferred and preference shares?

A No, sir, I don't. I looked at it both from a direct monetary payoff type possibility and also the possibility that somehow the exchange had given Cities Service something of value by exchanging debentures for a vague and nebulous and quite unlikely obligation.

After looking at it from both the direct and indirect basis, I concluded that there was no consideration equal to the $49,671,950 given to or received by Cities Service Company.

Q Did you compare the status of a bond holder as against a preferred shareholder in your analysis?

A Yes, sir. In addition to my past understanding and experience, I reviewed, again to make sure and most or all textbooks that I could readily find on the

subject of finance typically treated the bond holder as holding a legally enforcible obligation to the company, whereas the preferred or preference stockholder did not hold such a legally enforcible obligation.

The preference or preferred stockholder merely gets, typically, a preference to the assets upon liquidation or preference to dividends if declared before common would get dividends declared.

Failure to pay interest can result in bankruptcy -- I say can and quite likely will result in bankruptcy proceedings.

However, failure to pay a preferred or preference dividend does not usually, or does not resort to bankruptcy.

Failure to pay, in this case, build up, arrearages did not somehow magically upon the exchange of the preferred and preference stock for debentures make the past preferred dividends an obligation. The bonds did, though, become an obligation and had to be paid, or the debentures had to be paid.

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Q In your study of the situation in 1947, did you uncover any indication that the preferred or preference shareholders were anticipating a payment of the arrearages or perhaps the public might have been anticipating the payment of arrearage?

A I did a rather thorough analysis that covers the pages 7 through 15 of my report. The analysis was of investor behavior to determine if the payment of arrearages was anticipated absent an SEC organized reorganization.

Q What did you conclude?

A After the detailed analysis, I concluded that absent the SEC edict, absent the simplification, it was obvious that the investor in his behavior and we can study that behavior by studying the prices of stock specially, the behavior indicated that the investor was not anticipating the payment of arrearages.

Q What data did you study in arriving at the conclusion that you have just stated?

A The first segment of my analysis and the data that I studied is reflected on Schedule 1 of my attachment, appendix designated Appendix A.

I wanted to go back to a period where the company was paying its dividends on a preferred stock

and had no accumulated arrearages, and I wanted to compare that period and the prices of that period with a subsequent period where there were arrearages and where there were no dividends being paid. Therefore, I chose the year 1923 and I carried it all the way to 1946 and I show the detailed high-low and average price for each of the issues, the $6 preferred, the $6 preference BB and the 60 cents preference B on that Schedule 1.

The usage of prices here was with the recognition that a particular price on a particular day or particular month does not necessarily represent the value of all the shares outstanding, but I think such prices do have use and we can study such prices for trends and changes in investor behavior.

The way I used the data was taking the $6 preferred stock as an example on Schedule 1. I took the prices and I studied those prices for investor behavior, namely, for instance, in 1923, the average price was $67.125. I carried those things out sometimes further than we have to because they were reported in eighths, but certainly $67 is all that is important.

However, the dividend of $6 was paid each and every time, 1924 through 1928. The average price increased dramatically from the 1923 level as can be

seen from the table. It went in 1923 from 67.125.

1924 it was 75.312.

1925 it was 82.688 and it went up in 1928 to 99.00, and had been increasing steadily through the years.

Q What happened subsequently? I notice it goes down.

A Yes. In the year 1929, the average price fell but not to the pre-1924 level, to 91.375 and even in 1930, it was 86.02.

Then in 1931 when the dividend was again passed, after being paid only through June 1, the price fell again to a low of $35 and averaged about $60.

As the history of the non-payment of dividend lengthened, the price continued to fall until 1935, surprisingly hit a low of $6.125, slightly more than one year's dividend.

So, a purchaser of that stock could have bought that stock at $6 and if the dividend had been paid in subsequent years, he would have received each of the subsequent years the same amount in dividend that he paid for the stock.

The studying of this data gives me an indication that during the period of no payment of dividends,

the price had fallen substantially. Then, in later years it stayed low.

We can study the data, and it stayed low but in 1943, 1944, 1945, 1946 we saw a noticeable improvement in the prices, especially in the year 1945 and 1946.

The problem with studying such data as Schedule 1, it doesn't take into consideration the difference in dividend yield that could be obtained in other securities. The general interest rate movement might have changed, so I felt it was necessary to double check, so to speak, or to corroborate my analysis by looking to prices of Cities Service stock in light of general interest rate movement of other preferred stock.

So, I did the analysis on Schedules 3, 4, 5 and 6 of my appendix.

Again, using that data, it reaffirmed my conclusion that the investor behavior did not indicate that they were anticipating the payment of arrearages on the preferred stock.

Q Will you take a look at Schedule 3, and tell us, describe to us why that schedule is pertinent to your consideration?

A Yes, sir.

Going on to Column 4 of that schedule, I

appraised the relative yield factor which the schedule shows as the Column 2 divided by Column 3. I perused that Column 4 and went down and noticed that when the dividends were not being paid and where there had been accumulated arrearages, substantial arrearages, in, for instance, the year 1934, the relative yield factor was 6.490, indicating that the investor in his pricing of the preferred stock of Cities Service, as opposed to the pricing of a series of stocks that were paying its dividend, the relative yield compared 32.32 for Cities Service to only 4.98 of the high grade preferred Moody which I used as my calibrating device and we get a factor of 6.490.

However, we can go back to the early years. For instance, 1924 to 1930, and we can notice the almost outstanding stability of that relative yield factor in Column 4. 1924 it was 1.379.

1925 it was 1.287.

1926 it was 1.253.

1927, it was 1.265.

1928, it was 1.237.

1929, it was 1.311; and

1930, it was 1.437.

Those years, if we add them up, we get a yield

factor, a relative yield factor of 1.310, but when we compare what happened in 1934 with that standard that we have developed, we say that the stock price of Cities was very low or looking at it another way, the yield was very high compared to the standard of those companies which were paying dividends on the preferred, an the reason this was, the investor obviously was not anticipating the payment of preferred stock dividends in the year 1934, whereas in the years 1924 through '30, he showed that he was.

Going down from 1934 when the yield factor was 6.490, I perused again Column 4 and came all the way down to 1945 before my standard of 1.31 was reached.

I was able to conclude by investor behavior then, that obviously the investor was not anticipating the payment of arrearages and the resumption of current dividends until possibly 1945. But, he wouldn't even in 1945 be anticipating both the payment of arrearages, resumption of current dividends or the price would have been even higher and the relative yield factor would have been even lower.

Schedules 4, 5 and 6 are the same type of analysis for the other two issues.

Q I would invite your attention to Schedule 6

and ask you to describe more fully how you examined this; if it was any different from your earlier description of Table 3?

A For summary purposes, I have taken the relative yield factor and put it for each of the preferred and preference shares, put what was Column 4 in Schedules 3, 4 and 5 on Schedule 6 and again, perusing Column 2 of Schedule 6, again I am able to look at the very stable relative yield ratio from the period 1923 through 1930. I can see how again it peaked in the year in 1934, just as it did for the $6 preferred series in Column 1.

I can see where again the standard established for the years '23 or '24 through 1930 was not reached again until the years 1945 or 1946.

Going over to Column 3 where it is shown for the 60 cents preference B shares, I can see where the period 1924 through 1930 there was a relatively stable factor. Again, we get a peak in 1934 and again, we don't get our standard that was established in the period '24 to '30 until the year 1945, 1946.

The fact that prices raised in 1945 and '46 seem obviously that the investor was anticipating something other than merely the resumption of dividends, and certainly the payment of arrearages, he was obviously

assuming something was in the wind here and I think it was quite obvious to the investor that the simplification plan, some simplification plan was going to be put together and the investor was starting to reflect some of that antiicipation in the prices he was paying.

Q Did you find any indication in examining the financial statements of the company and the other authorities to whom you looked that there would have been any basis internal to Cities Service for this increase in stock price?

A I did study that possibility and the next section of my report from page 15 to page 21 dealt with the analysis of financial data to determine if the payment of arrearages was financially feasible.

Q What did you conclude?

A Again, after studying many ratios which I will desribe, I came to the conclusion that it was not financially feasible for Cities Service to have paid off its arrearages. It was a substandard operation from the viewpoint of the investment analyst. He would conclude that the payment of such arrearages would have been, while, maybe someone would argue possible, it would not have been financially feasible to do so.

Q How do you account for the increase in '43 and

'44 which preceded the plan of simplifcation?

A The increase of the prices?

Q Yes.

A As I have indicated, I think the investpr had something before him that could indicate to him that there was going to be a plan of some type that might possibly give him something other than a piece of paper. I point this out on page 14 of my report.

As early as December 23, 1940 when Cities Service first was subjected to regulation by the SEC, some plan was a distinct probability.

Also, on July 3, 1941, the SEC instituted a Section 11-B proceeding in regard to Cities Service Company and all subsidiaries.

As we are well aware, hearings are not held in a vacuum. Knowledge of what the purpose of a Section 11 hearing was under the Public Utility Holding Company Act would have, I am quite sure, given the investor some speculative basis for assuming that he was going to get something for his piece of paper.

Q You have stated that your analysis shows that under normal operations and without the intervention of a Securities & Exchange Commission reorganization or plan of simplification, Cities would not have or could not

have paid off the arrearages and resumed current dividends or called the stock.

Could you tell us what led you to that conclusion?

A Yes. In detail, starting with Schedule 7 of my report, or Schedule 7 of Appendix A of my report, I took in Column 1 the net income after tax.

Column 2, I showed the dividend arrearages and in Column 3, I showed net income as a per cent of arrearages.

In Column 4, I took the payoff period in years.

I think the data on Schedule 7 could be used several ways to show that the investor could not have looked to the performance of the company to give him reason to pay substantially higher prices for the preferred stock.

It is interesting to note that as late as 1942, Cities Service Company had net income of only $2,520,830. This is shown in Column 1. The lowest level over the entire period.

What is also striking, the level increased to $4,662,050 in 1943, still lower than six out of the seven years, 1935 to 1941.

Between 1 942 and 1943, it can be recalled

that the price data shown on my Schedule 1 of the appendix, the prices of Cities Service Company's preferred and preference stock took a noticeable jump. Such jump was most likely not based on this rather sub-standard and lacklustre performance.

Similarly, even in the period 1943 to 1946, the average earnings was only $6,920,337 which was below the average of $6,9232,794 earned in the depression years of 1935 to 1938.

Indeed, even if we take the high of $9,786,416 shown for 1946, the results of this wouldn't have been known, I might add, until some time in 1947, and if we take that high and compare it with the high of $9,615,714 in 1937, it would have only been 1.8 per cent higher.

The amended plan was approved, was dated February 20, 1947 and was approved by the SEC on April 24, 1947. This would indicate that the earnings for the entire year 1947 did not exert any signicant influence on the stock prices of the preferred and preference so I didn't show the year 1947 on my schedule.

THE COURT: I think it might be a good time to interrupt now. We will adjourn until 2 o'clock.

(Luncheon recess.)

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jks

AFTERNOON SESSION

(2.00 p.m.)

WILLIAM R. FIELD, resumed.

MR. CASEY: Your Honor, before we resume the examination of Mr. Field, I would like your permission to release Dr. Backman, who has concluded his testimony this morning.

THE COURT: Surely.

DIRECT EXAMINATION (Continued)

BY MR. CASEY:

Q Mr. Field, before we adjourned for lunch you were discussing Sechedule No. 7 of Appendix A of your report. Would you please review how that schedule affected your analysis of the problem before us?

A Yes. I was comparing the net income in Column 1 over the years, trying to show that the company's earnings performance had not improved substantially and actually, when compared even with the depression years, was either substandard or lacked any particular, say, luster or appearance of doing very well.

The analysis also caused me to take certain base years or comparative years of net income with average price to show what happened to average price, and I asked myself did that change in average price of the stock have

justification in the net income performance. And as an example I took the Schedule 7 data for income, net income for the year 1937 and noted that it was $9,615,000 and the average price from Schedule 1 of the preferred stock was $37.50.

Then I noted the year 1946 the average price had increased to $145.50, still coming from Schedule 1 of my exhibit. However, the net income was only $9,786,000.

It seemed to me such improvement in price was not justifiable in light of the earnings performance.

I also looked to averages for the period 1935 to 1938 compared with averages for 1943 to 1946, and that comparison is on page 16 of my report and it shows that the average price of the stock increased from $38.89 to $114.33 whereas the average net income increased only from $6,932,000 to $6,927,000.

Q That was in fact a decrease.

A Yes, sir. So it is a percentage decrease.

So I concluded from that data that the price performance wasn't tied to the earnings performance.

Many comparisons on that schedule could be made. There is nothing magic about the years I've done. Some interesting ones would be:

If you took the net income for 1940, when the price was only $67, the net income w[illegible]9,000.

In 1945 the price had increased to $131, from Schedule 1 of our exhibit, but the net income was only $6,742,000, which is approximately 1 per cent decrease again.

We could also do it for the period 1940 to 1944, which showed an increase in the price to 58 per cent more than what it was in '40, but the income went down 4 per cent.

Using the entire schedule on page 7, Column 1 and the price data on Schedule 1, I could conclude, and did conclude, that the price performance was not a function of income performance:.

I think that my conclusion then from looking at Schedule 1, Columnl, was that there was no basis from an earnings viewpoint for the higher prices in the later period.

Q Still looking at Schedule 7, could you explain the significance of Columns 3 and 4 of that schedule?

A Yes. I wanted to try to get some kind of yardstick or standard to determine how large were the arrearages in certain years relative to the income or the ability to pay those arrearages if it was assumed

that all income was available for payment.

As I pointed out in my report, though, I don't think it is really realistic to say that all income is available in the typical situation, and certainly not in the case of Cities during this period, to pay the arrearages.

But I said to myself, assuming it was all available, what would be the payoff period, the number of years it would take to pay off the arrearages, and that is shown in Column 4. And also I wanted to show the relationship or magnitude of net income as a percentage of the arrearages, and that is shown on Column 3.

And then I can take this data and compare the relative well being that Cities Service found itself in later years compared with earlier years, and that is shown on page 17 of my report, where I show that the net income as a percent of arrearages in 1937 was 29.64 per cent, in 1946 it was only 19.7 per cent.

And then looking at the payoff, which is really just the inverse of the net income as a per cent of arrearages, I show the payoff period in years of 1937 was 3.37 years, in 1946 it was 5.08 years.

I have also shown it for average periods.

1935 to 1938 the payoff would be 4.46 compared

to a payout ratio of 6.72 for the years 1943 to 1946.

However, you could make many different comparisons on that schedule. You could compare, for instance, 1940, as recently as 1940.

In Column 3 we saw where net income as a per cent of arrearages was 22.31 and the payoff was only 4.48 years. However, in the years '43, '44, '45 and '46, all those years later, the payout was much longer and the per cent of income, or the income as a per cent of arrearages, was much smaller.

So, using that schedule on Columns 3 and 4, again I drew the conclusion that from the earnings viewpoint there was no optimism pertaining to the potential payoff of arrearages.

Q I would now direct your attention to Schedule 9 of Appendix A of your report.

A Right.

Q I ask you the significance of that schedule in your analysis.

A For those who might be following the schedules, the reason we skipped Schedule 8, that is merely a work paper for the arrearages shown on Schedule 7.

Schedule 9. I have shown for a relatively long period there the times interest was earned on an

after tax basis. The after tax interest earned shown in Column 3 is merely the result of dividing Column 1 by Column 2.

The after tax interest earned reflected in Column 3 reflects (1) what I consider a very substandard performance of coverage, and later I'll get into some of the yardsticks or standards I used to help me draw the conclusion that these are substandard.

But in addition it shows me that the level of that substandard performance over the entire period shown here actually in many of the years, of the later years, '41 to '45, were at least as poor as earlier years, '35 to '40, or in some cases even lower.

So again looking at the coverage from the viewpoint of the preferred and common stockholder, the coverage of the interest after tax and what is left over for the equity owners has actually been substandard and did not indicate a likelihood that the company should pay dividends, arrearage dividends.

jgrf 1b-1 p.m. Field - direct

Q When you refer to it as sub-standard, with what other groups or companies did you compare the Cities Service performance?

A The need for yard sticks I think is very apparent. It is always one thing to just say something is low, but we have to show it is low in comparison to something else. So what I did was I went to the Cities Service Company's report, balance sheet report and income statement reports. I analyzed the company from the viewpoint, especially the income statement, of what was the underlying source of the company's dividends and interest representing the substantial income that the parent company earned.

The consolidated report indicated that the flow of revenue, the flow of income, which is the wherewithall of earnings and the ability to pay upward to the parent, dividends and interest on debt, indicated that primarily the revenue came from petroleum company operations, followed by electric and also natural gas.

So I chose to compare Cities Service Company both on a consolidated basis and a parent only company basis with three relatively large sample groups of companies that I was familiar with.

One of these, the FPC Class A and B Electrics, is a group of companies of all the companies that report

to the FPC in a publication that I have listed there in my source, quite often referred to as statistics of electric utilities in the U.S.

Then I took another broad group of companies, all the natural gas companies that report to the Federal Power Commission. That is shown in column four. And then I took a group of companies the data for which is compiled by the old Chase National Bank, which now is the Chase Manhattan Bank, and I am aware that they continued this series forward.

The comparison then of just this one schedule, schedule 10, shows me that in each and every case, either on a consolidated or a parent company only basis, Cities Service was sub-standard compared to the other three groups and especially compared to the group which I think is the most meaningful for comparison purposes, the 30 petroleum companies since the basic wherewithall of this company's ultimate income was very much associated with that industry.

When we compare the coverages for the natural gas companies and the Class A and B electric with Cities Service, we should realize that two FPC groups are recognized as companies of relatively low risk and have regulated income at a level which is usually considered to

to be the lowest possible level of income to protect the consumer.

So we have an ultra low standard or yard stick here to compare with and we find Cities did not live up to that ultra conservative and low standard.

But when we compare it with the 30 petroleum companies, which is a better standard in my judgment, we find it did much more noticeable poorer.

Q Did this lead you to any conclusion as to the employment of cash on the part of the company? That is, should it go to reduce debt charges or pay off arrearage, or what, in your opinion?

A I certainly think a company that is doing sub-standard ought to concern itself primarily with becoming standard. And certainly one way it could help to remove the problem more than it had done in the past is to pay off its indebtedness, to reduce the interest coverage -- I am sorry, to reduce interest and therefore increase interest coverage.

Q What bearing does this latter study have on your conclusion as to the analysis of coverage ratios?

A I got the first part of your sentence but I didn't get the last.

Q Excuse me.

4 jgrf Field - direct

Comparing the coverage ratios, as you have done on schedule 10, what bearing did this comparison have on your conclusion with respect to the potential pay off of arrearages?

A Again, it led me to the conclusion, as all my prior analysis had and all my subsequent analysis did, that the company did not find itself in a position that it would likely have paid off its arrearages and it would have been doubtful that the investor would have anticipated such pay off.

Q I would like to invite your attention to schedules 11 and 12 of Appendix A to your report, Mr. Field, and ask you the purpose for these tables.

A Again, I wanted to compare some meaningful financial performance ratios for Cities Service Company on both the consolidated and a parent company only basis with the yard stick or standard companies.

The schedule page 11, the analysis of the ratio, comparative rates of return on average total common and preferred equity capital, is what is shown.

Again, looking at columns 1 and 2, this schedule shows that Cities Service Company was below not only the 30 petroleum companies in each year, in every year, but it was also below the two very minimum conservative

type groups of companies, the FPC natural gas companies and the FPC Class A and B electrics.

Whereas on schedule 11 I was showing rate of return on average total common and preferred equity capital, the schedule on page 12 shows the comparative rate of return on average total capital. This includes debt whereas the schedule on page 11 excluded debt.

Again, the sub-standard nature of Cities Service's performance compared with the yard stick groups of companies is evident. In each and every case, in each and every year Cities Service, no matter whether you look on a consolidated basis or a parent company only basis, it was below the performance, financial performance of the three groups, and I have to keep on emphasizing the conservative nature of the groups shown in column 4 and column 5.

Q I would now invite your attention to schedules 13, 14 and 15 of Appendix A to your report and ask you to tell the Court the significance of these schedules.

A These schedules emphasize the relative size of the debt income, or looked at another way, the interest, as a factor in Cities Service Company compared with the yard stick groups.

For instance, schedule 13, where I have shown

net income as a per cent of net income plus interest, shows that Cities Service, as an example in the year 1946, even after there had been some improvement, on a consolidated basis earned net income which was only 64 per cent of the net income plus interest.

On a parent company only basis it earned net income which was only 61 per cent of net income plus interest, whereas the 30 petroleum companies, the part that flowed through to net income was 96 per cent. The part that flowed through to the FPC and natural gas companies as show in column 4 was 82 per cent approximately.

The part that flowed through to net income for the Class A and B electrics as shown in column 5 was 75 per cent.

Again, the conclusion is that much less flowed through to net income in the case of Cities than in the comparative groups.

On schedule 14, I am looking at it just the other way, or obverse or complemental to what I did in schedule 13, I should emphasize that schedule 14, if added for a particular year and a particular group to schedule 13, would equal to 100 per cent because the portion that flows through to net income or the portion

that follows through to interest, the two added together, would be 100 per cent.

So schedule 14 merely looks at it from a different viewpoint. The large size or the large magnitude of interest when you compare for the various groups, and again you draw the same conclusion, which shouldn't be a surprise because of the complemental nature of the two schedules, you conclude that Cities Service Company had much more of its net income plus interest flowing through in the form of interest than the other groups did.

In schedule 15, and continuing to show the magnitude of interest or the importance of interest, I've related it rather than to an income account, the way schedules 13 and 14 did, I looked to another yard stick. I related interest to a balance sheet account. I asked myself what was the interest as a per cent of the average debt capital. This is quite often referred to, especially in regulatory proceedings, as the imbedded debt cost.

A company with a relatively high imbedded debt cost is in a worse position interestwise than a company with a relatively low imbedded debt cost.

So here we can see that Cities Service, on

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schedule 15, both on a consolidated and a parent company only basis, fared very poorly when compared with the other three groups. It had the highest imbedded debt cost in most years, especially when we take the parent only company it had very, I think a two time -- over a two times -- or almost a two times ratio compared to the 30 petroleum companies, in many cases.

Q In your opinion, then, do these schedules 13, 14 and 15 indicate the advisability of employing cash to reduce debt or to pay off arrearages?

A They definitely indicate to me that the company had a strong need for reducing interest charges and they also indicate to me a practice unavailability of an adequate flow of income to pay off the arrearages.

Q I would now invite your attention to schedules 16 and 17 of Appendix A to your report and ask you to describe the significance of these schedules and in your conclusion.

A Schedules 16 and 17 is just primarily to show the relative size of the debt of the other comparative companies.

My conclusion is after looking at this, Cities Service Company's debt -- I am sorry, I am talking about 17 first. I skipped page 16.

Is it possible to have my response read to this point?

(The record was read.)

A (Continuing) Schedule 16 shows the long term debt capital as a per cent of total capital whereas schedule 17 shows common and preferred capital as a per cent of total capital.

When I appraised both of these two schedules together, I come to the conclusion that Cities Service Company's debt capital represented a substantially higher percentage of its total capital than what seemed to be economically and financially feasible, specially when we compare,such as schedule 16 where we compare Cities Service Company with 30 petroleum companies, where

it seems the magnitude of the debt is two to three times what the magnitude, the relative magnitude of the 30 petroleum companies' debt is, when we recall that the basic wherewithall of this company's ability to earn is very heavily and primarily related to petroleum company operations.

Q That last comparison you made was to the parent company, is that correct?

A Yes, but you could also draw a conclusion the consolidated company also had a higher debt ratio than the 30 petroleum companies.

Then on schedule 17, it is just the complement of schedule 17, it is just the complementof schedule 16. The two together equal 100 per cent and I draw the same conclusion from that schedule.

Q I would now invite your attention to schedule 18 of Appendix A of your report and ask you to tell the Court how this schedule influenced your conclusion and opinion?

A I used that schedule again to try to determine the reasonableness of someone arguing that the arrearages should have been paid on the preferred stock of this company.

The schedule shows the net income available for dividend of arrearages after consideration of current

preferred dividend provision and debenture purchased fund requirement for Cities Service Company for the years 1941 to 1946.

That data, specially in light of the high level of arrearages shown on schedules 7 and 8 of the exhibit, indicates to me the unreasonableness of expecting arrearages to be paid off from the operations of the business.

We can note that in column 5, we had several years there that actually would have shown a deficiency. This schedule assumes that all income is available for paying those off, but as I have indicated, as a practical matter, a company doesn't go off and pay off arrearages when it finds us in a substandard financial position or it certainly should not do so.

Q I will now ask you, Mr. Field, to state your conclusion after your evaluation of all of the data incorporated in your report.

A After having fully explored all my financial data from the question or from the viewpoint of either direct or indirect consideration, I have come to the conclusion that the arrearages in the amount of $49,671,950, nor any part thereof, do not constitute consideration. They do not represent anything received

or receivable by Cities Service Company and since I have already gone down through the other three categories that I have evaluated, my final conclusion is that only the $45,000 -- I am sorry. Only the $45,323,846 of original consideration received by Cities Service Company constitutes consideration received in respect of the preferred and preference stock, or value of any kind in respect thereof to Cities Service Company.

Therefore, since Cities Service Company by the issuance of $115,246,950 had obligated itself to pay out more than it received as consideration, namely, $45,323,846, the difference of $69,923,004, clearly represent the discount on debt.

MR. CASEY: Mr. Murphy, your witness.

CROSS-EXAMINATION

BY MR. MURPHY:

Q Mr. Field, my name is Dan Murphy. I am an Assistant and I represent the United States in this matter.

Can I have your birth date?

A March 9, 1933.

Q Have you read Judge Mansfield's opinion in this case?

A Yes, I have.

Q You just testified as to your expert opinion

which I take it was, on the 115 and some odd million dollars of bonds issued by Cities Service and in exchange for preferred or preference stocks and accumulated dividends of Cities Service, that some 70 million dollars of that is discount, is that right?

A Some 69 million, yes, sir.

Q The result of your testimony then is, Cities Service should have a tax deduction of that whole 69 million dollars?

MR. CASEY: I object to that. The witness is not competent to determine it.

THE COURT: He is testifying as an expert.

MR. MURPHY: I want to know whether it is a discount for tax purposes.

THE COURT: Why don't you ask him.

Q Is that 69 million dollars a discount for tax purposes for Cities Service?

MR. CASEY: Again, your Honor, I object. This witness is not an attorney. That is what we are asking you.

THE COURT: I imagine there is some purpose in his giving the testimony he has given but I don't know if he is the proper one to state -- I will permit him to answer.

A My only comment of the 69 million, it does not in my judgment represent consideration received by or paid to Cities Service and I have not drawn a conclusion as to whether it represents tax discount or discount for tax purposes.

Q Your report is Plaintiff's Exhibit 1 received in evidence in this case.

Do you have a copy of that report before you?

A Yes, sir.

Q Referring to page 1 of that report -- this report was written by you, sir, by the way?

A Yes, sir. I prepared it all but I didn't type it.

Q And you state here on page 1, the purpose of the analysis is to determine what value, if any, Cities Service Company realized upon the exchange of 115 million of three per cent 30 year sinking fund debentures on May 28, 1947 for its outstanding preferred and preference stocks over and above the 45 million received upon the issuance of said preferred and preference shares; is that correct?

A Yes, sir.

Q I notice that you don't include the accrued dividends which Cities Service also received on that

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exchange on that statement of the issuance. Was that an inadvertence on your part?

A The accrued dividends that Cities Service received?

Q There were accrued dividends --

A You mean the 49 million dollars?

Q Yes.

A My reason --

Q They are not mentioned in this issue as you state in the beginning of your report but you did state that Cities Service also did receive those accrued dividends.

A I didn't state that they received those accrued dividends.

Q So you didn't consider the fact -- well, isn't your testimony now that you didn't consider the fact that after the exchange Cities Service no longer had an obligation of any sort to pay the accrued dividends which had accrued on the preferred stock?

A My analysis of the accrued or accumulated -- I am sorry, its accumulated arrearages, of the $49,671,950, my analysis tells me there there was no likelihood that those arrearages should have been paid from a financial viewpoint, nor was it anticipated by the investor they would

have been paid until, evidently, the investor started seeing the event of some plan which would give them something other than their piece of paper, but I do not in my testimony conclude that Cities Service received 49 million.

As a matter of fact, I have tried to look at every possible piece of data to indicate what they received and I see nowhere did Cities Service receive anything similar to 49 million dollars. That is certainly part of my analysis.

Q So, the reason that the accumulated dividends were left out of your issue here that you state at page 1 of your report under "Purpose" is because you evaluated those accumulated dividends at zero, as far as Cities Service is concerned?

A From the viewpoint of Cities Service, I appraised the question of whether or not Cities Service received anything in consideration equivalent to the 49 million and my answer was, they did not.

Q In the approach that you followed, is it a fair statement that you followed the ditty that you gave me at the beginning of your testimony, that value of the thing is the price which it will bring, in making this analysis?

A Yes, but I think the problem is, "The thing." I looked upon it from a concept of what would be the monetary value that Cities Service received and if it didn't get a monetary value, then I say that that was zero. I followed it in that sense.

Q And you broke up the items which Cities Service was receiving into four categories, is that right?

A The word "receiving" bothers me. They didn't receive these four categories. They issued debt at a face value of 115 million dollars and I tried to show that the components of that 115 million dollars, some of them, namely one, represented something that Cities received. The other three, my conclusion was they didn't receive.

Q Your conclusion then, was, those four components, you valued each of those four components, is that right?

A I considered those four components to see whether Cities Service received consideration equal to those four. My conclusion was, only one of those, namely number 4 page 2 was one that Cities did receive consideration for.

Q Did you consider any other components that Cities received as a result of that exchange?

A I didn't conclude that they received these

other three. I am having trouble with your term "received." Cities did not receive these other three and did not receive consideration thereof. They issued an obligation equal to these four things. They received consideration for only one of them, 45 million.

Q Let's start from a different standpoint.

I ask you, assuming there was a preferred shareholder who owned preferred stock of Cities Service. What were his rights, if his preferred stock was redeemed for cash by Cities Service?

A If redeemed for cash, he would receive face value and if it was called in the sense it was called, he would receive a premium.

THE COURT: This didn't happen.

MR. MURPHY: I am asking this for hypothetical purposes to consider in what the expert has gone through in reaching his opinion.

Q A preferred stockholder, assuming hypothetically his shares were redeemed or called by Cities Service Company and he turned over his shares in response to that call, what would he give up?

A His contract right.

Q What were the items that he would give up, sir?

A His contract rights.

Q What were those contract rights?

A Well, in this particular case, it would be to receive those dividends which were declared, if declared.

Q That is accrued dividends?

A No. You mean -- I have trouble with people using the term "accrued." If it was the accumulated arrearages, I would say definitely not. The accumulated dividends by definition would not be declared, he has no right to them. He only has a legal right -- as an economist and financial analyst, it is my understanding he only has a right to receive a dividend which has been declared. It is the problem with preferred stock. The investor when he invests his money in preferred, he is aware of this problem that if the company doesn't tell him the company is going to let him have the dividends, he doesn't have a right to it.

Q Is it your testimony that this preferred and preference stock of Cities Service, it is your understanding, it could have been called by Cities Service on their payment to the stockholder of the stated value of such shares and the call premium and no payment of any accrued undeclared accumulated dividends?

A That wasn't what I understood I said. You asked me what was he giving up if he transferred this and I said his contract right.

Q Assuming he gave that up in 1947, May of 1947, what would he give up?

A Literally a piece of paper that gave him so many shares of preferred or preference stock that would have been a contract, so to speak, that entitled him under certain events to get a certain thing, if those events occurred.

Q I am asking you to assume that the event which occurred was that the preferred stock was called by Cities Service for cash.

What would Cities Service have to pay to the shareholder in order to call the preferred stock as they existed on May 24, 1937 if they redeemed it in cash and what would the stockholder give up to Cities Service, ifyou know?

A The stockholder would give up his piece of paper, which is the contract right.

Q What would Cities Service have to pay to that stockholder?

A The contract calling the call price plus the arrearages, plus face value.

Q So he would pay the stated value of the preferred stock, the call premium on the call and the accrued dividends in cash?

MR. CASEY: Your Honor, in order that the record may not be confused, I wish counsel would use accumulated dividends. Accrued has a meaning in law.

THE COURT: I am translating accrued as we go along. It is accumulated.

MR. MURPHY: Excuse me, your Honor, accumulated dividends.

Q And you considered in this analysis, from the standpoint of Cities Service, what its receipt of the shareholders right to stated value, the shareholders right to call premium and the shareholders right to accumulated dividends, was worth to Cities Service in your analysis?

A I considered what those contingent rights were.

Q Those contingent rights, and that is basically how your analysis worked?

A I definitely considered or asked myself what considerations did Cities Service receive for all this 115 million dollars.

Q Did you consider that the preferred stockholder was giving up anything other than those three

contingent rights in exchange for these debentures?

A In the very narrow confines of your question, no, I did not. I considered many things. I haven't considered any more contingent rights.

Q So you didn't consider, then, that the preferred stockholder was giving up his right to vote as a result of this exchange?

A Yes, that is part of the contract right, that is effective voting power was not substantial. He could not overcome the effective vote.

Q You did consider it or you didn't?

A I did consider it.

Q But it is not written in your report?

A No. That is part of the analysis that I did, by knowing it, by looking at it but I didn't put down they didn't have the effective vote, no.

Q Referring, sir, to page 3 of your report, you had really four components, shall we say. The call premium on this preferred stock; the accumulated dividends on this preferred stock and the stated value on that preferred stock which is made up of -- stated value is also made up of two components, one, the alleged consideration received when this preferred stock was issued and second, the difference between stated value and such

consideration; those four components?

A Yes, sir.

Q And you stated that three of them had no value whatsoever; correct?

A After my analysis, yes, sir.

Q And one of them had any value at all?

A Yes, sir.

Q Talking about the original discount first, which is at page 3 of your report, the second paragraph under sub part A, says, "Obviously the 13 million dollars by definition could not be consideration since the aggregate value which Cities received was only 45 million dollars."

Right?

A Yes, sir.

Q And that 13 million is the difference between 45 million and the stated value of this preferred stock which is some 58 million?

A Yes, sir.

Q Plus the 13 million by definition.

What do you mean by definition?

A By definition, if I am told somebody received something of value of 45 million, then by definition they didn't receive something of value for 58 million.

Q Does it mean anything else, this definition? Does it mean anything else in that context?

A No. To me if something is of value of 45 million, it is not of 58.

I am rounding all these figures. That is where we get into this all of a thing. I want to make sure that the value of a thing has some monetary value or at least able to be converted into monetary value.

Q In that same sense, what did you mean by consideration?

A Something either tangible or intangible but with monetary value which Cities Service received.

Q And monetary value to ~~him~~ whom?

A Cities Service.

Q "Unfortunately merely stating something has value does not create value."

A Yes, sir.

Q You would agree with the converse of that, merely stating something has not value does not create absence of value?

A Yes. If I have 45 million of value, that is all I was trying to say, I couldn't have 58 of value.

Q Where did you get that number $45,328,426 as the consideration Cities received?

A Very early in this analysis, I think it was last October when I was first asked by Cities to do an analysis of the whole problem, I read substantial findings by Judge Mansfield and in there, I believe, that figure was there, but I indicated to the company -- it was there or somewhere else, but I indicated to the company, if I were to say that the value was that, I could not without another analysis truely determine that was the value, so in finalizing my report, I asked them could we rely on that figure and I was told it seems we could because we had an order signed by Judge Mansfield, I think it was in February, that said that that was the value; so I did not go beyond that in my analysis.

Q So you just took that as given, in order to

make your analysis?

A Yes, sir.

Q And you did no independent research yourself to substantiate that number?

A That would be a substantial assignment.

Q The answer is, you did no independent research?

A I did not do an independent research of the 45 million some-odd.

Q I note it says in the last sentence of this subpart A, page 3 --

A The last sentence?

Q "The difference between the stated amount and the amount actually received has been made good by a charge to surplus."

Do you see that, sir?

A Yes.

Q What is the basis for that conclusion by you?

A Ultimately after all these many, many transactions we have, if it really had a value, stated value of 58 million 690 and if we received only 45,323,846, ultimately you had surplus to give. If the 45 million was something higher than 45 million, the discount would have been lower. If the 45 million wasn't 45 million and something lower, the discount would have been higher,

but somewhere in my accounting, my surplus had to suffer by the difference of what was really the difference between stated value and market value.

Q So what an accountant should have done, in theory, is make a charge to surplus of the difference between the 58 million and the 45 million?

A Well, it doesn't have to be done by the accountant. I don't like to say what accountants should or shouldn't do. They have a hard time some time with their own profession what they should or should not do, but as a concept to mean anything, if there was something that wasn't representative of value in a stated value, then that something should ultimately work to reduce the common equity of the company.

We had so many examples of where people would just book something, put it on the books, millions of dollars, just putting a debit-credit. That does not create value.

If there was a false or poorly indicative figure put on as value, then I say a proper charge had to be put in a surplus account.

Q You don't know whether that charge was ever made, of your own knowledge?

A The specific entry I do not know, no, sir, I do

not know.

Q Talking about number A there, that is two-thirds of the page on page 3, that is all the reasoning in your analysis you gave to that original discount so-called, isn't that correct, Mr. Field?

A Yes, sir.

Q There is no other part in your report that talks about original discount except that two-thirds of the page?

A I think that is right.

Q Let's move on to call premiums.

Do you see at page 4 at the beginning of the text at the top, first of all you say "Again, the $6 million does not represent consideration received by Cities Service Company."

That is just a statement without any actual proof for it, it is standing of itself?

A It is a statement after analysis.

Q It comes before the analysis?

A I had already done it.

Q That standing in itself is very much like your unfortunately merely stating something has value does not create value; somewhat in the same sort of sense, as you stated earlier?

A The two sentences are different enough.

Q All right, let's move on.

The next sentence on page 4,

"By its nature, call premium i always a penalty payment for which no monetary consideration is received."

Did you write that?

A Did I write that?

Q Yes.

A Yes.

Q You said monetary consideration is received. You meant received by whom?

A Cities Service.

Q So what you are saying then, the so-called issuing company as opposed to the person who is the stockholder, the issuing company gets no consideration for a call premium, right?

A Right. The one that pays the issuing corporation is the one that pays the premium.

Q You say that premium is worth nothing to them by its nature?

A The fact they have to pay it, it is money out of the pocket. I used the term penalty. I didn't want to be redundant. I could say a call premium is a

premium.

THE COURT: This was not a call?

THE WITNESS: No.

Q You say when a call premium is paid by a corporation, then the corporation gets nothing for it; is that your statement?

A They get the piece of paper that they call. They don't get anything for the call premium other than the piece of paper and/or the contract rights that represents.

Q What is the purpose of a call premium?

A To tell the investor that in case something is called, there will be something over and above a stated amount will be paid. Like his other rights that he is given.

Q Why would a corporation put a call premium into its description of stock?

A To tell the investor in that stock, that under certain circumstances he would get something just like we tell them they would get dividends under certain circumstances, but those dividends that are never paid are just never paid. Those premiums that are never paid are never paid. As I say, they are contract rights. Under certain circumstances, we know what to expect. An

investor likes to have those rights that he is buying spelled out in contract form.

Q When would a corporation choose to redeem stock by paying the stated value of the stock plus the call premium?

A I wouldn't want to get into all the situations why they may decide to do that. I could not pretend to know all of the cases.

Q Can you say in general why they would do that?

A Why they would pay a premium? When they want the stock back.

Q Why would that be, in general?

A I would say if there was a strong interference wi0th the normal running of their business because the stock effectively, which didn't in this case, if your preferred stock effectively had a vote for a take-over, which didn't in this case, if your preferred stock effectively had a vote for a take-over, I will try to give an example, Hearst Consolidated, a stipulation in its 7 per cent preferred for many years that was outstanding, that if the company passed its preferred dividend more than, let's say, and I am going back in history a little, more than two-quarters out of any given year in succession, that the vote of the common stock would go to the preferred

stockholder.

In that case I could see very well if a company found itself on hard times for 10 or 15 years and unable to pay its dividends, the vote would have passed to the preferred. The effective vote of the preferred may have been a conducive or certainly a stimulant to the company to pay it a dividend but there we didn't have that effective control.

Q Hypothetically, if a corporation was paying its dividends on its preferred, say of 6 per cent and the interest rate on borrowed money was 3 per cent, wouldn't it be advantageous to the corporation to redeem its preferred, at say the call price of 100 and issued bonds in lieu of that 6 per cent obligation?

A I would be very hesitant to recommend to a company, especially this company, with the financial analysis I have gotten, to recommend to that company or any company similar to it, that it take what is a contingent contract right of the preferred stockholder to convert that into a very firm, very legalistic obligation that could very well, if the wrong set of circumstances continued, could have meant the actual financial demise of this company. I think they would be getting very poor financial advice.

THE COURT: We will take a short recess.

(Recess.)

BY MR. MURPHY:

Q Mr. Field, did you as part of your analysis and study consider the financial condition of Cities Service over say, six or seven years prior to 1947?

A Yes, sir.

Q Was it your opinion that Cities Service's financial condition had improved from 1940 to 1947?

A Improved but for the whole era, still sub-standard compared to the comparatives that I used.

Q In fact, it had improved?

A Many of the later years my ratio show it was actually performing poorer in like '45 and '44, than it was in earlier years such as '40 and '41.

Q I just would like to know whether their financial condition overall from 1940 to 1947 improved?

Can you answer that yes or no?

A Because I don't want to take one year as being an indication of improvement in earnings versus many years of poor performance, I don't want to conclude that the financial viability and finance ability of this company had improved to a noticeable extent that I would conclude it had improved. An investor of this company

would not want to close his eyes to the performance of these years that I have shown.

Q Is it also your testimony that viewing it from the standpoint of the company itself, as opposed to an investor outside of the company, that the corporation, Cities Service Company, the holding company, had not improved between 1940 and 1947, its financial condition?

A Do you want to take just '40 and '47, if one were to compare just those years, one might conclude that they had improved over that period, but that doesn't mean their financial viability and finance ability had improved. It is the question of what you want to look to and what I want to look to to draw my conclusion, but if you say strictly and my answer is understood to mean strictly, was the earnings in 1947 higher than the earnings in 1940, my answer would be yes. If that is what your question is.

Q Did you prepare Schedule 11 in this report of yours, Plaintiff's Exhibit 1?

A Yes, sir, except for the typing.

Q Do you have the same conclusion as to whether the financial condition of the Cities Service complex as a whole improved or did not improve between 1940 and 1946?

A Again, just taking the year 1946 and comparing it solely strictly to 1940, there was an improvement.

In the interim, there had been strong indication they had actually disimproved, if you want to look at the year 1945 versus 1944, for instance.

jg-T3 Q I'm just referring to your schedule here, Schedule 11. It takes in both years 1940 and 1946.

This is your own schedule, right?

A Yes, sir.

Q You compare this 3.73 per cent rate of return on equity capital in 1940 for the consolidated Cities Service Company, to the 8.42 per cent rate of return in 1946. Looking at those two numbers.

A Yes, sir.

Q Will you take my calculations as accurate that that shows a 127 per cent increase?

A Yes, sir.

Q Now looking over at the 30 petroleum companies, your Column 3, if you take the 6.29 per cent in 1940 in your schedule and compare it with the 10.27 per cent in 1946 on your schedule, would you agree with my calculations, sir, that that shows a 64 per cent increase?

A Approximately, yes, sir.

Q And doing the same thing as to 4, it shows a

31 per cent increase?

A Yes, sir, approximately.

Q And in 5 a 24 per cent increase?

A Yes, sir.

Q So off your chart Cities Service has improved 127 per cent as compared to 64, 31 and 24 per cent, isn't that correct?

A If you mean improved meaning just these ratios, they are still substandard, and this is the important point. The comparison is between Columns 1, 2, 3, 4 and 5 within themselves, not the comparison one abstracted here compared to another.

Q All right.

Now, in substandard -- what do you mean by substandard?

A Below my standard groups that I tried to set up here as yardsticks to determine whether the financial performance of this company Cities Service met the standards of this broad group or three broad groups of other companies that in the business that Cities Service relied very much on for its flow of income through the interest and dividends.

Q By the way, are these companies you are comparing it to all holding companies?

A No, sir. I've tried to indicate I've looked to the underlying nature of Cities Service's flow of income, the wherewithal that it comes to. Dividends and interest aren't paid out of the blue. They have to be earned. So I went back purposely to the companies of the nature of the business that Cities truly relies on, and there primarily was petroleum, and secondarily was the electrical and natural gas companies. So that's why I used them.

Q But then again, if you look at your own chart, Schedule 11, you will see that Column 1 is fairly comparable to the other groups because Column 1 considers the whole Cities Service complex instead of just the parent company. So Column 1 really isn't a holding company, then.

A If I answered your question, you said that these were comparable. Your assumption is not just right. If I look, for instance, to 1945 for the consolidated, it is 4.92. For the 30 petroleums it is 8.60. For the natural gas, the real safe earners, the regulated companies, the electric or the gas, it is 9.05 and 7.44.

If I do that each year, I come to the same conclusion. The Cities either consolidated or company only

was below these other groups.

Q Now, these other groups are what you consider the standard that you compare Cities Service to, is that correct?

A Yes, sir.

Q And you are stating that Cities Service is substandard until it gets its financial situation in line with these comparable groups, is that correct?

A I'd say it would be a very good analysis. Yes, an investor would hope that it could be up to the industry standard before he would want to seriously put new money in.

Q So until Cities Service was the same as the average company in these fields you would consider that Cities Service was substandard.

A Yes, sir.

Q Now referring back to page 4 of your report, sir, do you see that third sentence in the text:

"At no time did Cities receive anything as consideration equal to that amount."?

A Yes, sir.

Q That was not the issue which you set yourself when you decided the question whether Cities Service received any consideration for the call premium, was it,

sir?

MR. CASEY: Your Honor, could counsel restate that question? It is unintelligible as it stands.

THE WITNESS: I do not understand it, your Honor.

THE COURT: Would you repeat it?

Q The point is this:

You are asking yourself in that third sentence whether Cities Service received consideration equal to the amount of $6,885,000. But they could have received, say, $6,686,000 or 6,383,000 and still not have received consideration equal to 6,885,000, correct?

A I see. I am probably guilty of, I guess, poor language. But what I mean is they did not receive anything as part of or in total equal to 685. They didn't receive $1, $2, $3, all the way up to $6,885,000.

Q They received nothing on the call premium; that's your testimony.

A Yes.

THE COURT: Would they have received anything on the 45 million that they originally received?

THE WITNESS: No, sir.

THE COURT: That would form no part of that.

THE WITNESS: Pardon me, sir?

THE COURT: That would form no part of the 45 million that they originally received on the stock?

THE WITNESS: I stand corrected. If it did, and I'm not sure whether it did or did not --

THE COURT: I was just asking you.

THE WITNESS: I don't know. If it did, it is in the 45 million that I've used here, and I wouldn't want to be guilty of double counting, so to speak.

I guess I should say that the proper wording of that is that they never received anything from any of these things over and above the 45 million.

Q Do you see on page 4 to 5 of your report you are saying that rather than call its preferred and preference stock and pay the accumulated dividends Cities "Would have, as it had often done, purchased the shares on the market at substantial discounts from face value much less from call price."?

Do you see that?

A Yes, sir.

Q But in fact that wasn't a viable alternative to Cities Service, was it?

A Well, my whole thing, absent the simplification plan and all those things leading up to this, which is what caused all of a sudden the stock to have value, the

preferred stock started going up -- absent that, they could have. And even up to 1940, obviously even with the SEC, they could have. They didn't even become registered under the Act until '41, if I recall January 29.

But even subsequently, and I think I touched on this in my direct, that the Rule U-42 actually had the exemption in it where they could (1) with permission or (2) without permission -- they could evidently acquire $50,000. This is exemption No. 6 of Rule U-42. They could acquire $50,000 each and every year.

And, as I indicated, in low price stock, some of these prices, if you recall, after a pattern of non-payment of dividends, if we look at Schedule 1 -- after a pattern of non-payment of dividends the prices reached some very low levels: '35. The $6 preferred was down to 60 cents.

Q But that regulation wasn't in effect in '35, was it? So let's just talk about 1941.

A I am trying to use it as an example of what could happen to price of stock when dividends are not paid. If dividends are not paid, prices, as an example, can fall, as they did in '35. The $6 preferred went down to as low as 60 cents.

Now, a person looking at the number of shares of the preference B, for instance, at those prices a person could buy up a nice little lump of those at $50,000 a year and retire them. He could conceivably go forward with this if there was no payment of arrearages.

But my general analysis was, under this, let's assume the SEC did not indicate this situation where we finally led up to where Cities Service was going to give its preferred stockholders something.

Q So you are assuming then that there was no limit on Cities Service' right to go into the market and purchase these preferred and preference shares as part of your analysis on the call premiums, are you?

A That was not one of my basic assumptions, no.

Q So your answer to my question is that you did assume that they could go into the market or you did not assume they could go into the market?

A I did not assume an unlimited right to go into the market.

Q So this sentence on page 4, instead of as it had often done, purchased the shares, is limited to only $50,000 worth of those shares a year, right?

A Not for those years that that regulation didn't apply. As I tried to point out, they were unlimited

in the years 1940 -- up to 1940. They were discussing the whole history here of why we could have looked upon this that Cities Service could have bought their preferred stock in the market.

Q What about 1947? Could they have bought it then?

A I doubt if they could have bought -- well, $50,000 is all they could have bought, I assume.

Q So as far as 1947 is concerned, it wasn't a viable alternative for Cities Service to go into the market and purchase these shares.

A At that point in time I would say there was very little chance they could have.

Q So at the prices of 1947 you could not consider that Cities Service had the alternative of going into the market and purchasing its own shares.

A Not in 1947.

Q Those pages from 3 through 5 are the only discussion that you give as to call premium, isn't that correct, sir?

A Yes, sir.

Q Now talking about accumulated dividends, what were the accumulated dividends that Cities Service had built up on its preferred and preference shares in May

of 1947?

A The accumulated arrearages were $49,671,950.

Q What did you value that accumulated arrearages at as far as Cities Service was concer..ed?

A I came to the conclusion, after all my analysis, that Cities Service did not receive any consideration for any portion thereof.

Q So the accumulated arrearages were valued at zero by you?

A Yes. I hate to value something at nothing, but yes.

Q If it wasn't nothing, what was it, sir?

A I guess you are right. It is nothing.

Q So 49 million was valued at zero, right?

A 49 million of accumulated arrearages were found by me to have zero value to Cities Service, yes, sir.

Q On page 6 of your report, sir, the last sentence of that first paragraph you say:

"In the instant situation the failure to pay dividends did not give the holders of the preferred and preference shares any additional rights."

Did you write that?

A Did I do what?

Q Did you write that?

A Yes, sir.

Q Was that a factor which you considered in coming to the conclusion that the $49 million in accumulated dividends was worth zero to Cities Service?

A It was one of the things that I took into consideration, yes, sir. The more important things were my full analysis of the ability to pay and then the investors' expectation of that payment.

Q How many years had the dividends been passed by Cities Service, do you know?

A From 1932 to 1946, with one payment of $3 per share in 1941. I have it in a footnote. I had better glance at the table instead of relying on my memory.

On the $6 preferred stock there was a payment of $3 in August of 1941, as shown by Footnote 3 on Schedule 3, and then no dividends were paid full years '33 to '46 and only a part dividend was paid in 1932.

Then on the preference shares, both B and BB, there was no dividend paid in 1941 or any other year 1933 to '46.

Q But you considered that the failure to pay dividends did not give the holders of the preferred any rights.

A It gave them the contract right they already

had, which was in the event that the company ever was able to and wanted to pay common stock dividends, that it would pay by contract its arrearages to the preferred stockholders. That's a contract right they had, not the main thing I've done, but it dates right back to when the preferred stock was issued.

Q Isn't that a right which the preferred stockholders had to prevent the corporation from paying any common stock dividends until those accumulated dividends had been paid off?

A No. The company, at the time that they went into the agreement to any time subsequently, could have, as far as I can see, not paid off the arrearages, could have ultimately, maybe at $50,000 a year, and I won't go into the niceties of it -- they could have actually, way down the road, retired, part each year, all these securities by purchase and they could have, again without going into the niceties of it, paid common stock dividends.

There could have been other alternatives. The company could have, looking at this from 1941, '42, actually bought the dividends, bought back the dividends, so to speak, by buying the stock.

Q Is it your testimony that the company had an alternative of never paying these accumulated dividends

but purchasing back the preferred stock at $50,000 a year as long as it took until all of that had been bought up and then issue dividends to the common?

A Well, I'm not saying that was the distinct one and only alternative. It was a possibility, from my understanding.

But that's not what I based my whole analysis on, if that's what you mean. They could have just left the preferred stock stand out there, if the right set of circumstances had occurred.

Q Now referring you to 316 Federal Supplement at page 72, the decision of Judge Mansfield (handing), do you see where he says,

"In the present case, for instance, even though the accrued and unpaid accumulated dividends did not constitute a firm obligation for which the plaintiff had received any consideration, the preferred and preference shareholders could use the dividend provisions of the charter to preclude plaintiff's management from paying any dividends on the common . . ."

Do you see where he says that? The full sentence is . . . "and to restrict the uses to which plaintiff's earnings could be put."

Do you see where he says that?

A Yes, sir.

Q And you were familiar with that opinion in that statement, weren't you?

A Yes, sir. I didn't get it in this form. If I recall, I got it in what was a mimeo -- I don't have all those services that you have. I had it in, I believe, a mimeo original opinion form.

Q Did you consider that statement and fact as being a right the preferred stockholders had with respect to the accumulated dividends?

A Yes. I took it in light of meaning that under certain contingent events that the preferred stockholders did have certain charter rights, which they did have.

Q And what did you value that right as?

A At the time that I could see that here was no particular voting control that was definite to go to the preferred, and because I was well aware of the many instances where preferred stockholders are told to live up to their contract agreement, that they will get only their contract rights, and since the contract right was to receive dividends when declared, then I felt that they were not going to -- the preferred stockholders were not going to have a particular monetary right --

Q And did you value --

A -- that Cities Service received any consideration thereof so that, when it issued the debt, that it removed an obligation.

Q In short, did you value that right at zero?

A I valued the prospect and value of the arrearages to Cities Service at zero, yes, sir.

Q I am asking you what you valued this sentence at:

"In the present case, for instance," --

MR. CASEY: Your Honor, I think he has asked the question now three times and he has gotten the same answer, and I think it is time he moved on.

Q Is your answer zero, sir?

MR. CASEY: He just gave the answer, sir.

Q Is that your answer?

A I've never been in the position of placing a value, a monetary value, on a sentence. But if you were asking me after considering that sentence is my valuation opinion of the arrearages zero, my answer is yes.

Q Okay.

Now still on page 72 of Judge Mansfield's opinion, it says:

"Furthermore, it is possible that circumstances

might arise where they could" -- "they" being the preferred stockholders -- "force the management to declare and pay part or all of the accrued dividends."

Did you read that sentence?

A Yes, sir. And I agree with it.

Q All right. What did you value that possibility at?

A Again, I don't value it. But after taking it into consideration, I said to myself that certain contingent events could occur, that what were accumulated arrearages, which were not obligations to Cities Service Company and therefore at the time that they were converted into debentures had a value to Cities Service of zero, at some time a certain set of circumstances might have occurred that could have given those possibly some value.

But they didn't have after my analysis at that time. There were still contingent payments of accumulated arrearages, which we see quite often in the financial field.

Q And what did you value that contingency at?

A Zero.

Your Honor, may I say that I am saying that

in my evaluation, after considering that, there was zero value to it. I am bothered by evaluating sentences.

THE COURT: The value to the plaintiff.

THE WITNESS: Yes, sir. Well, who is the plaintiff? Yes, sir.

Q Now, directing your attention to page 16 of your report, what you were trying to do, wasn't it, was to value these preferred and preference stocks and your accumulated dividends to Cities Service as of 1947? That was the object, correct?

A That they received for the exchange in 1947, yes, sir.

Q And you said that the value of the accumulated dividends was zero, right?

A Yes, sir.

Q That table at page 16 shows the net income of Cities Service Company to be exactly the same, or for our purposes the same, in 1937 and 1946, is that correct?

A Right, yes.

Q How was the net income of a company used to value that company's stock?

A Well, especially from the viewpoint of common stockholders we find it is a fairly important indication. Certainly, though, there are many other things. But it

seems that a company's value that flows through to the underlying securities certainly is very much dependent upon the level of income.

When we value industrial going concerns, we quite typically try to look to the level of income that those industrial concerns are able to use, to earn. I use the term "industrial concern" meaning a going concern, an industrial enterprise rather than some co-operative that people just get together and say let's make enough to cover our expenses of living together. I am looking at it from the viewpoint of a company, an industrial project, and income to my mind is a very important part of that.

Q In general would you say that it was a fair estimate to make that if the company is the same in two different years and the income is the same in those two different years that the price of the stock should be the same in those two different years?

A It is not always that easy. I wouldn't want to say that that's all I have to do to try to determine what the value of the stock should be, especially if we mean common stock.

Q You say that that kind of analysis is defective?

A It is certainly part of my analysis and it is

good to look to that type of thing, especially from the viewpoint of preferred stock.

Q Is that part of your analysis, sir, in this case?

A Part of my analysis is to compare the level of income to see whether there has been an improvement in that level of income both in one year and several years, to see whether or not there was a justification in price improvement. And after that analysis I concluded that the price improvement certainly did not seem to be too closely or at all associated with the income -- I wouldn't say improvement because it wasn't always an improvement.

Q So would your statement be in general that if you have the same stock and the same income in year 1 and you have that same stock and the same income in year 10, the price in year 1 should be similar to the price in year 10?

A You don't just take just the end points, but you study the performance of net income over a period of years, as I did, and you compare '37 to '46, '35-38 average to 43-46 average, and always, as I did in my direct, I pulled out other years to show that in earlier years, when the price was low and income was a certain amount,

we looked to income and it didn't improve, yet price shot up drastically.

Now, if the price had gone up maybe 10 per cent and earnings stayed the same, I might not want, as an analyst, to say that the income and the price didn't seem to be too well associated with each other. But where we are looking to such drastic improvement in price, I'm looking to the income performance to ask myself does this kind of income performance justify that kind of increase in price.

Q What was your answer?

A In the preferred my conclusion is that that kind of increase in price does not seem to be justified in that kind of behavior of net income. Common stockholders might come along and make a much different analysis because there is a speculative anticipation type investor. They may look and see just one year a little bit of improvement. That might be at the right time that will make them go out and pay double and triple what they were paying for the stock before.

But it is not the behavior you expect of a preferred stockholder who is sitting there paying $6, $30 and then all of a sudden he is paying $105, $120.

We ask ourselves why was he was willing to do

that, and the answer is that it probably wasn't associated to income.

Q All right.

Now, the stock in 1937 was different from the stock in 1946 because there was more accumulated dividends on each share of stock in 1946 than 1937, isn't that correct?

A Right. But my point was that that's why I tried to show that we could even -- after there had been many years of arrearages we paid no dividends on Schedule 3, no dividends, all the period 1933 to '46. Yet the investor told me that despite now the fact that dividends had been accumulating for many years, the investor was going to pay less of a price for stock, less of a price for stock.

We had a price in 1935 that was $6. Accumulated arrearages in '35 were more than they were in 1930. Yet the investor only paid $6 in 1935. Yet in 1930 he paid $78. There was no accumulated arrearages in 1930. Yet he was willing to pay much more.

This to me is an indication the investor wasn't expecting the payment of arrearages. He was expecting probably not even to get his dividends, his current year. And that's what the whole purpose of Schedule 3, 4 and 5

and 6 were, to evaluate investor behavior.

We can draw, it seems, some rational conclusions of what the investor possibly was anticipating. He wasn't even paying prices in 1933 to 1943 that indicated to me that he was expecting current dividend payment. If he was indicating current dividend payment, he would have been paying a price yield, or yield price relationship, that would have been a relative factor of only 131, whereas he was paying a relative dividend yield in 1943 of two.

So I had concluded that he certainly wasn't paying for arrearages because he was not even anticipating current dividends. If you don't pay your current dividends, you just build up more arrearages.

Q Referring to page 16, sir, just taking that table right there, the difference between the 1946 stock and the 1937 stock is not in the net income, it is not in the share or the voting power; the only difference is, or two differences are, the price and the increased arrearages.

And I ask you whether you didn't consider that since the only difference between the two, only two differences, were arrearages which were increased and a price which was increased, that simple correlation analysis, shall we say, would state that the rise in price

was because of the increased accumulated dividends.

Did you consider that?

A No, because the correlation analysis is not quite correct, and that's why I tried to show that the correlation analysis would indicate to you that price actually fell when arrearages went up. So a correlation analysis would tell me that price should go up when arrearages went up.

And in my correlation analysis that's why I tried to show to you that price went down to $6 when arrearages went up.

So investors weren't buying arrearages; they would only buy arrearages if ultimately they thought those arrearages were going to be paid or they were going to get something for their money other than their current dividends and arrearages.

Q Well, you can't show that conclusion from the table on page 16, though, can you?

A That table on 16 in conjunction with my evaluation of price data on one, yes, I can.

Q But on page 16 alone you can't show that, can you?

A No. Page 16 is one step in all my analysis. I've gone to many things: the payout ratio, the payoff

period, the net income as a per cent of arrearages, the performance of the company, an evaluation of six pages of price statistics to determine investor behavior, to draw the conclusion that the investor was not anticipating the payment of arrearages.

And that's not what made the price go up, because before, when arrearages were getting higher and higher and higher, the price wasn't going up, up, up; it was going down, down, down, and this is what my whole page 3, 4, 5 and 6 is all about.

Q But you weren't valuing the stock as of that earlier period. You were valuing it as of the later period in 1947; isn't that correct?

A But I'm doing it --

Q Is that correct?

A Yes, sir.

Q Okay. Aren't you comparing preferred stock, which is declaring and paying a dividend, with preferred stock of the same company, Cities Service, which is not declaring and paying a dividend in this analysis?

A Yes. I purposely did that.

Q It is the same preferred stock of the same company. The only difference is that in one case it is paying a dividend and in the other case it is not.

A No. I am sorry. I thought you meant was I comparing Cities Service stock that was not paying a dividend with stocks that were paying a dividend.

THE COURT: Of other companies.

THE WITNESS: Of other companies. And I did. That's what my Schedules 3, 4 and 5 show. The other companies are the Moody's high grade preferred. That's what I wanted to do. I wanted to show what Cities price behavior indicated to me when it was and wasn't paying dividends compared with what the price behavior and yield result for a group of Moody's companies that were paying their dividends, and from that I was able to draw conclusions, analytical conclusions. I didn't want to compare Cities with companies that weren't paying dividends.

Q Looking at schedule 6, it compares Cities' relative yield when it is paying dividends to those when it is not.

A But I am not comparing them --

Q Just answer schedule 6.

Doesn't that compare Cities paying dividends with Cities not paying dividends for preferred?

A I don't want to be argumentative, but that schedule shows the result of schedules 3, 4 and 5 and schedules 3, 4 and 5, the way column 4 was obtained, was by dividing Cities Service yield, assuming it paid dividends, with the yield on Moody's high grade preferred, so the result on page 6 is a comparison not only of Cities when it paid dividends and when it didn't, it is also a comparison with other companies.

Q Okay, thank you, I stand corrected.

This number of 1.3, I don't know where it shows on schedule 6.

A It is page 11 of my report. I have pulled out those years that showed what I thought a most astounding consistency in that ratio for the column, really I was talking about schedule 3, but it is also on schedule 6.

Q The 1.3 is the ratio between the comparable preferred stock when Cities Service is paying dividends

and when the other companies are paying dividends?

A Yes. Assuming Cities Service paid dividends and in those years it did pay dividends, comparing that yield with the yield of the Moody's preferred, yes, sir.

Q In fact, Cities Service paid no dividends from 1933 to 1946 except for that half dividend in 1941, is that correct?

A Exactly, yes, sir.

Q But despite the fact Cities Service paid no dividends in that period, you still use that 1.3 figure in your analysis to compare the price allocated to the preferred stock portion of this preferred stock plus accumulated dividends to the price allocated to the accumulated dividends portion in 1945 and 1946; is that right?

A I am bothered by allocation. I will have to have the question read again.

(The question was read.)

A I can't answer your question. I don't understand what it means. I don't think I have allocated anything in my study at all.

Q At page 12, the second paragraph which bleeds over into the next page, "Therefore, even as late as 1945, the preferred stockholder in Cities Service Company

at the most was expecting only a resumption of current dividends, or alternatively, he was expecting a lump sum payment and no continuation of current dividends."

'At the moment, he was expecting only a resumption of current dividends, how do you reach that conclusion?

A That again gets to my approach if we go to schedule 3. I have tried to determine from investor behavior at a time when he was receiving dividends and when there were no arrearages, I have seen that the investors in a very surprisingly consistent way told me that he would quite typically pay a price which would result in a yield shown in column 2. That yield when divided by the yield of a group of companies which were paying their dividends at all times, indicated that the investor would normally for Cities Service stock when it was paying the preferred dividends and when it had no arrearages, would pay approximately 30 or 31 per cent more or less in price which would result in a higher dividend yield than the Moody's group.

Then, I come down and I show what happens even after 1932. Dividends weren't paid and quite expectably, the price of the stock fell. The yield on column 2 rose. It rose very substantially to where the yield factor in column 4 indicated that the relative yield of Cities

was 4, 5 and 6 per cent -- 4, 5 and 6 times the relative yield factor of the yields on Moody's high grade preferred.

Then, that same attitude occurred, continued, wherein the purchasers of the preferred stock paid such low prices that I could continue to go down column 4 and see that the investor, by his behavior, was telling me he still did not anticipate that there would be a payment of a current dividend, because as soon as he anticipated the payment of a current dividend, I asked myself, what would the figure in column 4 be and from the experience up in 23 to 30, I come to the conclusion, a good percentage or ratio expected there would be 1.3.

But because I didn't reach that point to 1944, I am able to conclude from his past performance, a very rational performance, he indicated to me he was not expecting the payment of dividends, and certainly not the accumulated arrearages.

Q After 1944, since the ratio was now below 1.3, on the same analysis, you assumed any stockholder who purchased that stock must be expecting to get dividends?

A No. I was saying I think by then he was showing me from his behavior and because I indicate that the feasibility of his receiving dividends from a company that was earning substandard on its capital and on

its revenue, he wasn't expecting arrearages, he was expecting something --

Q He wasn't expecting arrearages or dividends?

A Arrearages or dividends. He was expecting something, a result of these hearings that were going on and he anticipated that something was going to come to him in exchange for his piece of paper and that something would have a hearing, had had a hearing going on; that something he hoped would give him what a reviewing court would find to be equitable and fair in light of Section 11E of the Act.

He did not in his behavior tell me he was truly expecting dividends to be paid because -- that is the second section of my analysis -- looking at the performance of the company, he had no basis for that expectation absent a court edict organization, that was my title in my whole section here starting with page 37.

Q You agree, don't you, your relative yield after 1933 when you compare them, are comparing Cities Service preferred which isn't paying any dividend to other preferred stock which is paying a dividend, right?

A Yes, I purposely did it that way.

Q Is it possible that under your same analysis, that nothing could be allocated to the expectation

of resumption of dividends or to the payment of preferred dividends and the whole price for the investor should be allocated to the arrearages?

A That would fly in the face of my entire analysis that indicates there was, what I consider a rather obvious substandard level of financial operations of the company.

Q And substandard, again, by the way, you mean compared to the other companies in the group, or other companies in analogous fields?

A Yes, and to itself. I don't even see where the wherewithall would come. As we look at schedule 18, that schedule tells me that I wouldn't get my hopes up too high on expecting arrearages to be paid. That is internal to just an analysis of Cities Service.

Q This whole analysis and these schedules is from the standpoint of the market investor, is that correct?

In other words, you are looking at the value of these companies from the standpoint of the market investor, the value of this preferred stock from the standpoint of the market investor?

A On schedules 1 through 7, I believe, 1 through 6, those are from the viewpoint of the investor but my others are looking at it from the viewpoint of anybody

concerned with the financial viability and feasibility of this company.

Q 1 through 6 that we have been discussing, is from the standpoint of the market investor, right, value from the standpoint of an investment?

A Investor behavior indication, not value. I haven't got a value figure on any of these.

Q Page 14, at the bottom of page 14, you say, "It is understood that company counsel had advised that the Act required elimination of the preferred and preference shares even if Cities had chosen to remain a registered holding company."

Do you see that?

A Yes, sir.

Q Understood by whom, sir?

A Understood by me.

Q What was the basis of that understanding?

A Frankly, I think I got it in a meeting -- am I allowed to name names -- a meeting, I believe, it was Mr. Robinson, Mr. Casey and Mr. Tyre, primarily with the ones I was talking to at that time. I don't want to unjustly blame aany one man. I think the one I got my understanding more from than anyone else was Mr. Robinson, but he is free to deny that, I guess.

MR. ROBINSON: I don't want to deny it.

A It was just an understanding, I must admit.

Q Who had company counsel advised of that opinion?

A I thought they advised Cities Service. I mean I thought they advised the management of Cities Service.

Q Pages 15 through 21 are your consideration as to whether the payment of the arrearages was financially feasible on the part of Cities Service; is that correct?

A Yes, sir.

Q And your conclusion was, what?

A That they did not appear to be financially feasible, the payment of arrearages. It did not appear to be financially feasible.

Q And that was as of what time?

A Well, again, all that period leading up to the exchange.

Q Did you read the opinion by the Securities and Exchange Commission on the actual approving of this exchange?

A Yes, sir.

Q Are you familiar with that opinion?

A From after reading of it. I couldn't recite the whole thing to you. Again, I had it in a different form. I believe I had it in mimeographed form.

Q I refer you to Appendix B of that opinion. As of balance sheet of Cities Service Company as of October 31, 1946, what were the total current assets of the company?

A I am reading at page 605 and it seemed to be $88,951,985 on a per book basis.

Q How much of that was cash?

A The table you have handed me I don't believe shows how much was in cash.

Q How much is in cash in United States Government securities?

A $88,780,821.

Q So almost the whole 88 million was in cash and Government securities?

A As is stated there, yes, sir.

Q Do you see the current liabilities in the same balance sheet for Cities Service Company as of October 31, 1946?

A Yes, sir.

Q What were they?

A $14,829,845.

Q What was the net current position of Cities Service Company on October 31, 1946?

A The use of your term there if you mean just

the difference, I would say about 74 million dollars.

Q Did you consider that figure in reaching your conclusion that it was not financially feasible to pay off the arrearages?

A Yes, sir, absent the reorganization, the company would not have sold, or might have not sold or if they did sell, they might have chosen to use that money to do what I think would have been a very fine and very important thing, that would be to reduce the interest via the payment of debt and to get itself back into a place where it would be a much more financially viable and much more comparatively speaking, a much better earning company than what was indicated by my analysis on all my schedules.

Q Was it your opinion that in May of 1947, it was the time to start paying off all your debt if you were a company in existence at that time?

A At that time, I am sure that would have been a very strong recommendation on my part after analyzing this. Hindsight is great.

Q Schedule 7, referring to thatpart of your report, do you see that?

A Yes, sir.

Q Column 1, what was the meaning of net income

in that column?

A There it is the reported net income after tax to the company and after all other expenses. It was available to what we call the equity.

Q Was this annual income?

A Each of those years represents annual income, yes, sir.

Q Column 4, what is the significance of that column?

A As I tried to indicate in both my testimony and the report, I tried to get, even though net income is not available each and every year to pay off arrearages, I was trying to get a ratio that showed the ability to pay off. One thing that had come to mind is the number of years that it would take to pay off the arrearages assuming all the income was available to pay those arrearages.

So, I merely divided column 2 by column 1 and that told me the number of years, then I compared that answer I got that I showed that actually we found ourselves getting a larger payoff in later years than we had in earlier years.

Q What does that mean, a larger payoff?

A It took more years to pay off. For example,

in 1942, it would have taken 14 years of the level of 1942 income to pay off the arrearages of $35,637,775 which had been accumulated by the end of the year 1935 -- 1942, I am sorry.

Q How did the payoff period run after 1942? Did it become greater or less?

A Lower than that peak, but higher than, for instance, if we take, because we need some magnitudes. If we take '43, '44, '45 and '46 and compare it with '35, '36, '37, we will see that the answer is higher.

Q Were the accumulated dividends the same in '35 and '37 as they were in '45 and '46?

A They got higher.

Q They got higher when?

A In later years.

Q So when it took, say, five years to pay off in 1946, there were more accumulated dividends than it took to pay off in 1935?

A Certainly. That is the thing I am showing. The burden of paying them off was greater. I could look at it in absolutes or I could look at it in relatives. The burden of paying off 49 million dollars was more of a burden than paying off 23 million dollars and I could always look at some relatives. The burden in 3 and 4 is

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Thanks again

for Casey Craig Constance